STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois American Water Company	)	
Request for Increase in Water and	)	ICC Docket 09-0319
Sewer Rates	)	

EXCEPTIONS AND BRIEF ON EXCEPTIONS OF

THE PEOPLE OF THE STATE OF ILLINOIS

Oral Argument Requested

The People of the State of Illinois

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I. Introduction and Request for Oral Argument

The People of the State of Illinois by Attorney General Lisa Madigan ("AG" or "the People") file the following exceptions to the Proposed Order issued by the Administrative Law Judge on February 22, 2009 ("Proposed Order"). Although the Proposed Order includes substantial discussion of the parties' proposed adjustments, the Proposed Order fails to reasonably limit the growth of IAWC's expenses and would allow the vast majority of the increase requested by the Company. IAWC originally requested an increase of $58,626,634 and subsequently *increased* its overall claimed revenue deficiency to $60,519,567 in supplemental testimony. Sch. A-2 Second Revised (filed on e-docket September 22, 2009). In its surrebuttal testimony it accepted adjustments and changes to its cost of capital, bringing the requested increase down to $50,138,634. IAWC Ex. 6.01 SR; Proposed Order, App. A, col. e. The Proposed Order would allow the company to increase rates by $44,702,406, constituting an overall 24.62% increase in revenues, although it varies by district from 17.64% to 28.80%.[1] These are substantial increases since the last test year ending June 30, 2009, less than two years ago.

It is crucial that the Commission take a close look at the costs IAWC includes in its 2010 future test year, and critically assess whether the cost increases in the test year are reasonable and prudent. Analyses in this docket demonstrate that significant portions

[1] Page 1 of each Appendix B – F to the Proposed Order:
Zone 1: 24.25% Pekin: 25.36% Lincoln: 27.46%
Chicago Metro Water: 28.80% Chicago Metro Sewer: 17.64%

of IAWC's claimed costs have been escalating at an unreasonable pace, are excessive and imprudent, and must be adjusted to just and reasonable levels.

A. Request for Oral Argument

The People of the State of Illinois request oral argument to present the issues associated with this increase to the Commission. The size of the increase, the burden on consumers, and the numerous contested issues all demonstrate the need for the Commission to hear directly from the parties.

The Public Utilities Act requires the Commission to hear oral argument upon request of any party, including the Attorney General, who has submitted a post-hearing brief. Specifically, the law provides:

> The utility, the staff of the Commission, the Attorney General, or any party to a proceeding initiated under this Section who has been granted intervenor status and submitted a post-hearing brief must be given the opportunity to present oral argument, if requested no later than the date for filing exceptions, on the propriety of any proposed rate or other charge, classification, contract, practice, rule, or regulation. 220 ILCS 5/9-201(c).

The People of the State of Illinois were granted intervenor status and filed a post-hearing Initial and Reply Brief. See e-docket filings on July 13, 2009, August 28, 2009, granting intervention, Transcript at 21), and January 7 and 21, 2010. Accordingly, the People are entitled to oral argument under Section 9-201(c) and request that it be scheduled so all parties can address the Commission. See also 83 Ill. Adm. Code 200.850.

B. Repeated, Double Digit Rate Increases Demonstrate The Need For Close Commission Review Of IAWC's Claimed Cost Increases.

As the following table demonstrates, since 2003 IAWC has received double digit rate increases, with some areas seeing increases of more than 40%.

District	Company Proposed 2009 Increase[2] (Direct Testimony)	2008 Revenue Increase Appendices to Order in Docket 07-0507	2003 Increase From Appendices to Order in Docket 02-0690
Total Company	***32.7%***		
Southern Districts – Zone 1	***33.8%***	***14.90%***	***13.51%***
Chicago Metro Water	***38.08%***	***5.28%***	***44.19***
Chicago Metro Sewer – Collection	***0***	***-15.58%***	***33.98***
Collection and Treatment	***63.5%***		
Pekin	***32.14%***	***21.21%***	***2.90%***
Lincoln	***35.95%***	***-.76%***	***13.68%***
Champaign	***34.7% (now Zone 1)***	***47.2%***	***15.70%***
Sterling	***26.3% (now Zone 1)***	***20.76%***	***51.15%***

It goes without saying that water and sewer services are essential services. Yet, residential consumers in IAWC's service areas are finding the cost of this essential service out of reach. Based on IAWC's original request, residential consumers using 7 ccf (which is equivalent to 5,200 gallons, and is IAWC's state average usage, Tr. 108) will see the charges they pay to IAWC for water service[3] and public fire protection charges, increase as follows:

District 7 ccf (=5,200 gallons) Fire Protection

[2] Staff Ex. 1.01; AG/JM Ex. 5.1, Sch. A; 2009 Sewer treatment rate increase: Staff Ex. 5.0 at 31 (revenue requirement calculations do not break out sewer treatment increase).

[3] In the Chicago Metro area many customers pay a separate charge for purchased water. IAWC only delivers the water – it does not provide or treat it.

Chicago Moreland	49.2%	42%
Chicago Well	49.6%	74.3%
Chicago Lake	46.3%	74.3%
South Beloit	41.2%	23.6%
Pekin	28.2%	32.2%
Zone 1	29.3%	21.6%
Sterling	26.3%	23.6%
Lincoln	43.6%	35.4%
Champaign	34.7%	15%

IAWC Exhibit 9.09, Comparison of Bills, pages 31, 35, 39, 43, 47, 51, 55, 59, 63; IAWC Exhibit 9.09, pages 15 (Zone 1) and 29 (Champaign); IAWC Exhibit 9.05. Although the exact rates at the revenue level in the Proposed Order will be proposed by the Company on the same day this brief is filed, at requested rates public fire charges for the Chicago area would increase from $4.74 to $7.86, while the customer charge recommended in the Proposed Order would increase from $9.75 to $13.50, **an increase in fixed charges of 47.4%**. Sewer collection customers also pay a fixed charge of $17.57 for sewer collection, adding up to a monthly bill of $38.93 before one drop of water is billed. Customers who receive sewer collection *and* treatment services from IAWC would pay $49.88, again before any water is used. Consistent with the Staff proposed revenue requirement (which is very close to the Proposed Order recommendation) and rates the fixed monthly charge for sewer collection and treatment would increase by $10.95: from $26.07 to $37.02, and increase the first block volume charge by 26.6% and second block volume charge by 148.5%.[4] Proposed Order at 189; Staff Ex. 12.0, Sch.12.1R, CWW, page 2.

The Commission should be aware that Chicago Metro neighbors who do not take water and sewer services from IAWC pay significantly less for water and sewer services.

[4] The first block would increase from $2.8418 to $3.5986, while the second block would increase from $1.4483 to $3.5986.

Mr. Robert Boros, a Mount Prospect resident, testified that while he *currently* pays $63.38 for 4,000 gallons of water, his neighbors pay less than half that amount – before the 28.80% increase recommended in the Proposed Order:

Arlington Heights	$17.44
Niles	$18.36
Mount Prospect (village water)	$24.76
Morton Grove	$24.64
Park Ridge	$30.76
IAWC	**$63.38** (AG Ex. 4.1).

See AG Ex. 4.0 at 4. Although IAWC has itemized costs, this huge disparity in charges for the same water and sewer services should cause the Commission to closely review IAWC's claimed costs and reject or limit the unreasonably large increases it seeks in this case by limiting the growth in expenses it claims. Repeated increases of more than 20% in a short period of time should not be accepted absent specific justification, which has not been provided in this docket.

<u>Exception I</u>: The Order Should Accurately and Consistently State IAWC's Requested Revenue Increase As A Proportion Of IAWC's Charges.

In presenting the Test Year and Proposed Revenue Increases, the Proposed Order appears to rely on the Direct Testimony of IAWC President Karla Teasley. IAWC Ex. 1.0 at 11. However, the percentages in her testimony are not consistently presented, and do not accurately present IAWC's request. The problem with these figures is illustrated by the fact that the Proposed Order would allow a revenue increase in excess of the Chicago Metro increase requested by the Company.[5] These numbers are not accurate and should be replaced as shown in the proposed language below.

[5] Appendix C, page 1 to the Proposed Order allowed a 28.80% increase in Chicago Metro, but page 4 of the Proposed Order shows that the Company only requested a 25.54% increase in that district.

The relevant measure of IAWC's requested increase is how much it increases IAWC's revenues. Revenues collected to pay purchased water or purchased sewer or other amounts that are forwarded to third parties or not included in the revenue requirement should not be included in the calculation of IAWC's requested revenue increase. In addition, Chicago Metro Sewer is made up of two distinct rate groups: collection-only and collection and treatment. The Company requested a 63.5% increase from collection and treatment customers while asking for no increase at all for collection-only customers.

The Staff presented the increase in IAWC's revenues in Staff Exhibit 1.0, Sch. 1.01 for each IAWC district. Although sewage treatment revenues were not broken out in those schedules, they were quantified and discussed in Staff Exhibits 5.0 (page 31) and 12.0R and related schedules. The increases shown above on page 3 are taken from the Staff exhibits and more accurately show the increases requested by the Company.

EXCEPTION I – Proposed Language: Test Year and Proposed Revenue Increases

On page 4, Section III should be amended as follows to show the increase in revenues IAWC originally sought in this docket:

III. TEST YEAR AND PROPOSED REVENUE INCREASES

IAWC proposes to use the 12 months ending December 31, 2010 as the test year in this proceeding. No party objects to the use of this test year. The Commission concludes that the future test year IAWC proposes is appropriate for purposes of this proceeding.

IAWC's Proposed Tariffs purportedly reflect an increase of approximately $59 million in additional water and sewer revenues. The proposed percentage revenue increases for each Rate Area of the Company are as follows:

Zone 1 (Southern/Pontiac/Streator/Peoria/South Beloit/Sterling/Champaign)	~~30.08%~~ 33.7%
Lincoln	~~35.59%~~ 35.95%
Pekin	~~30.90%~~ 32.14%
Chicago-Metro Water	~~25.54%~~ 38.08%
Chicago-Metro Sewer – Collection Only	~~24.29%~~ 0
Chicago-Metro Sewer – Collection and Treatment	63.5%

IAWC determined these revenues using a 12.25% cost of equity and a 9.43% rate of return on rate base. IAWC's last increase in its base rates for the districts occurred in Docket No. 07-0507. The Commission entered the Order in Docket No. 07-0507 on July 30, 2008.

EXCEPTION II: Although The Order Refers To The Five Public Meetings, It Should Include A Description Of The Rate Concerns Expressed By The Many Participants In The Meetings, And The Order Should Clearly Relate The Public's Concerns.

A. **The Public Participation In This Docket Is Extensive And Demonstrates Extraordinary Public Dissatisfaction With IAWC's Rates and Frequent Rate Increases.**

This docket represents the second large rate increase IAWC has sought in two years and the third since 2003. In response, the public has taken the opportunity to express their dissatisfaction with repeated rate increases. Five public meetings were requested[6] and hundreds of people attended. Close to 600 comments were posted on the

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[6] Section 8-306, Special Provisions Relating to Water and Sewer Utilities, was added to the Public Utilities Act in 2006 and provides at subsection (n): Rate increases; public forums. When any public utility providing water or sewer service proposes a general rate increase, in addition to other notice requirements, the water or sewer public utility must notify its customers of their right to request a public forum. A customer or group of customers must make written request to the Commission for a public forum and must also provide written notification of the request to the customer's municipal or, for unincorporated areas, township government. The Commission, at its discretion, may schedule the public forum. If it is determined that public forums are required for multiple municipalities or townships, the Commission shall schedule these public forums, in locations within approximately 45 minutes drive time of the municipalities or townships for which the public forums have been scheduled. The public utility must provide advance notice of 30 days for each public forum to the governing bodies of those units of

Commission's public comment line in this docket. The following twenty cities or villages intervened and/or submitted testimony:

City of Champaign	City of Des Plaines	City of Elmhurst
City of Peoria	City of Pekin	City of Urbana
Village of Bolingbrook	Village of Glen Ellyn	Village of Homer Glen
Village of Lemont	Village of Lombard	Village of Mount Prospect
Village of Orland Hills	Village of Prairie Grove	Village of Savoy
Village of St. Joseph	Village of Sidney	Village of Tinley Park
Village of Woodridge		

Glen Ellyn consumers Melody Fliss, Rosmary Katona, Harold Menger, Eileen Nelson, and Tim Nelson all intervened.

Eleven municipalities co-sponsored the accounting testimony of Ralph C. Smith with the People of the State of Illinois. AG/Joint Municipalities Ex. 1.0; Tr. at 510 (Dec. 10, 2009). Consumers Robert Boros and Avis Gibons of Mount Prospect prepared direct and supplemental testimony which was submitted by the People of the State of Illinois. AG Ex. 3.0-3.3, 7.0, 4.0-4.2, 8.0. The City of Des Plaines filed the testimony of City Manager Jason Bajor and Assistant Direct of Public Works and Engineer Jon Duddles. DP Ex. 1 and 2. Mayor Irvana K. Wilks of the Village of Mount Prospect filed Direct Testimony, MP Ex. 1.0; the Village of Homer Glen, which has about 6,000 homes

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local government affected by the increase. The day of each public forum shall be selected so as to encourage the greatest public participation. Each public forum will begin at 7:00 p.m. Reports and comments made during or as a result of each public forum must be made available to the hearing officials and reviewed when drafting a recommended or tentative decision, finding or order pursuant to Section 10-111 of this Act. 220 ILCS 5/8-306(n).

served by IAWC, filed the testimony of its Mayor Jim Daley, HG Ex. 1.0 (page 4); City Manager Mary Niemec, HG Ex. 2.0; Fire Chief Michael Schofield, HG Ex. 3.0; and engineer Aaron Fundich. HG Ex. 4.0. In light of this unprecedented participation and public concern, the Commission should carefully review the imprudent, unreasonable or unsupported expenses that have been identified in this docket.

In addition to testifying at public meetings and posting comments on the Commission's Public Comment system, two Mount Prospect residents offered testimony in this docket. After hearing about the rate increase, Ms. Avis Gibons attended an open house sponsored by IAWC on June 15, 2009. AG Ex. 3.0 at 4. After the open house, she put together letters to Chairman Box and the other Commissioners to voice her concerns about IAWC's rates and poor maintenance record and collected 154 signatures from 131 households. The petitions and signatures are attached to her testimony as AG Ex. 3.3. Ms. Gibons testified that several of her neighbors "recalled their shock upon receiving a bill from IAW and finding it to be three times higher than their former communities [Niles, Skokie and Chicago] for the same service and usage." AG Ex. 3.0 at 7. Her neighbors also complained about frequent rate increases and poor service. Id. Mr. Robert Boros, also a Mount Prospect resident and IAWC customer, also circulated a letter to the Commission "to voice concerns about the proposed water rate increase sought by Illinois American Water (IAW), and to ask you **please deny IAW any rate increase at this time**." which he attached to his testimony as AG Ex. 4.2. Together, they collected 212 signatures on a letter to the Commission

At the public meetings, several consumers spoke up, [7] but the comments of one young mother at the October 8, 2009 Mount Prospect Public Meeting sums up the problems facing IAWC consumers, and the need to limit the steady increase in prices IAWC has pursued over the past few years:

> I'm a fairly new resident. I wasn't really prepared to speak today, but I want to say that I'm really happy that a lot of the residents here came today and have stated great cases and have done more research than I have.
>
> But what I do want to state is that I'm very upset about how much you have to pay for water here. I lived in Niles and I lived in Chicago and now I live in Mount Prospect. And I would never have moved here if I knew how much more we were paying than my friend who moved to Mount Prospect and gets water from the Village. Period. I have a family. I have a new daughter. I was excited to come here, to live here, to be a citizen here. And -- I'm sorry -- we can barely make ends meet. I work a full-time job. My husband works a full-time job. We made sure to come here tonight to at least see and hear what's going on. And something has to be done.
>
> I'm stuck. What am I going to do? I just bought a house. So I have to pay this. And you know, I made a mistake, I guess. Mount Prospect is here for families? How? I'm standing right here in front of you fairly young and I'm telling you it's hard. Thank you.

Tr. at 61 (October 8, 2009). In the Chicago Metro area, the more than 40% increase in fixed water delivery and fire charges IAWC the Proposed Order would allow will drive

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[7] Randy Kemper, Alton Public Hearing, a customer of Fosterburg Water Company that buys water from IAWC in Zone 1 said: “We are talking about a rate increase of 30 percent every three years. Where is that going? That's going beyond anything that anybody increases in their home, in their own budget...And I just see the excess.” Tr. at 38 (Nov. 9, 2009, transcript filed November 24, 2009). In Springfield, James Faron said: Last year ... actually, in '08, it [the price increase] was 35 percent. This year it's now 47 percent. What business would ever attempt to do that? Other thoughts that came as a private business person -- mismanagement and poor planning.” Tr. At 26 (October 1, 2009, transcript filed October 16, 2009). Nancy Dietrich, a Champaign consumer said: “Now, I can't imagine what would happen if a government entity decided to raise its rates on anything by 81 percent, and if this company can't pay for a water treatment plant and cover its expenses with the increase from last year, I think it has a serious problem. Aren't businesses supposed to be more efficient than this?” Id. at 24.

already high prices even farther from the amounts paid by IAWC's neighbors See also Tr. At 52 ("my neighbor has lost two opportunities to sell his house because prospective buyers are not willing to pay what he pays for water.")**.** See also HG Ex. 2.0 at 4 ("unreasonably high water and sewer rates will drive builders and homeowners away from Homer Glen.").

The Commission has the authority to control IAWC's escalating costs by rejecting the huge increases in management services and rate case expenses; amending the Company's lead-lag study to more fairly reflect payment lag; rejecting the recovery of a "business study" that duplicates the services of the management company; adopting a cost of capital that includes a fair amount of short term debt at current, low cost; and rejecting a rate design that charges more in fixed costs than neighboring systems charge and that burden small users while minimizing the benefit of conservation.

As IAWC President Teasley stated, IAWC must control costs to control rates. Tr. 141. Clearly IAWC needs help in controlling its costs, and the following exceptions provide the Commission with several ways to limit the increase IAWC seeks in this case, providing IAWC with the necessary incentive to limit its spending, and so limit the already excessive rates paid by Illinois water and sewer service customers.

B. Consumer Concerns Should Be Discussed At The Beginning Of The Order To Establish The Context For The Commission's Rate Review.

At the end of the Proposed Order, at page 190-198, "Municipal Rate Comparisons and Other Intervenor Issues" are discussed. The evidence addressed in this section is crucial to the Commission's review of this case. It sets the context for the requested rate increase and should inform the Commission's review of the large increases in cost that IAWC is claiming since its last rate case – barely two years ago. As discussed above, on

July 30, 2008, based on a test year ending June 30, 2009, IAWC increased rates up to 47% while reducing other rates. In the first half of 2010, when unemployment is high, the economy is in recession, and people, businesses and local governments are making due with less, the Proposed Order would give IAWC increases ranging from 24.3% to 38.1% to close to 60% (waste water treatment) over costs set based on a test year barely 9 months past. See Proposed Order at 4. **The Commission should ask: is it reasonable for costs to increase so much in such a short period of time? What specific justification did the Company provide for these extraordinary increases?**

The Proposed Order should be modified to move the discussion on pages 190-198 to page 4, and insert it as Section IV. The hundreds of Public Comments, the hundreds of residents at Public Meetings, and the testimony of consumers and municipal representatives should not be treated as an "after-thought." The public response to the repeated rate increases for water and sewer service requested by IAWC is a strong indication of how the Commission should assess the reasonableness of IAWC's request.

The General Assembly mandated that public meetings be held upon request when water utilities seek a rate increase. 220 ILCS 5/8-306(n). Five public meetings were scheduled, showing a strong public interest. The law further provides that the comments made at the hearings are to be reviewed by the hearing officials. Specifically, it provides:

> Reports and comments made during or as a result of each public forum must be made available to the hearing officials and reviewed when drafting a recommended or tentative decision, finding or order pursuant to Section 10-111 of this Act.

220 ILCS 5/8-306(n). There is no indication in the Proposed Order that the comments in the public forums were reviewed and considered when the Proposed Order was drafted.

In addition, the Proposed Order fails to discuss the hundreds of comments on the Commission's Public Comment line associated with this docket. As of the date of these Exceptions, there were 591 posted comments. The statute mandating Public Comment clearly intended that the Commission be made aware of the comments it receives on the Public Comment line. Section 2-107 of the Public Utilities Act provides in relevant part:

> The Commission shall provide a web site and a toll-free telephone number to accept comments from Illinois residents regarding any matter under the auspices of the Commission or before the Commission. The Commission staff shall report, in a manner established by the Commission that is consistent with the Commission's rules regarding ex parte communications, to the full Commission comments and suggestions received through both venues before all relevant votes of the Commission.

220 ILCS 5/2-107. The Commission's rules reiterate that the Commission is to be informed of public comments:

> d) In formal proceedings before the Commission in which public comments have been posted on e-Docket, the Administrative Law Judge in the case or another Commission employee designated by the Executive Director will report the comments that have been posted to the full Commission, before the Commission votes on the matter. Parties to a formal proceeding before the Commission may respond to public comments by filing their own comments in the same section of e-Docket.

2 Ill. Adm. Code 1700.20(d). Although the Proposed Order describes some of the municipal testimony, it fails to include a discussion of the extensive public participation in this docket. The People offer the following proposed language, using much of the discussion from pages 190-198 of the Proposed Order, and adding additional language to relate the public participation in this docket.

Exception II: Proposed Language – Public Participation and Reasonableness

The discussion found in Section VIII.M., Municipal Rate Comparisons and Other Intervenor Issues, should be moved to page 4, and inserted after Section III and before Section IV Rate Base. Section IV should be renumbered as Section V Rate Base. The changes in the language from pages 190-198 are indicated below, with inserts underlined and deletions marked by ~~strike-through.~~ Minor changes, such as the elimination of a period or comma, will not necessarily be marked.

This section should be reorganized so that consumer concerns are stated first, and IAWC's response to their concerns is stated afterwards. The change in organization is not being marked for simplicity.

M. Municipal Rate Comparisons and Other Intervenor Issues

This section of the order primarily addresses concerns about the level of IAWC's water and sewer rates when compared to the rates charged by various municipally-owned water and sewer utilities. This section also addresses certain other issues raised by Intervenors and raised by the public on the Commission's Public Comment line and in the five public hearings held throughout IAWC's service territory, when members of the public were given the opportunity to speak.

Regarding municipal rate comparisons**,** Homer Glen and the AG cited the testimony of municipal and consumer witnesses as well as comments at public meetings and on the Public Comment line ~~complain~~ that IAWC currently has water and sewer rates that are far in excess of those charged by surrounding communities. Their positions are discussed below, after which IAWC's response is provided.

1. Public Meetings

The AG states that in the Public Forums across the state, consumers expressed frustration that their bills are two to three times higher than in neighboring communities. Mt. Prospect Public Forum at 24, 36, 42, 54, 57 (Oct. 8, 2009); Wheaton Public Forum at 54-55 (Nov. 4, 2009); Homer Glen Forum at 105, 116 (Oct. 19, 2009); Springfield Public Forum at 31.The AG also cited comments that ~~says they also commented~~ due to the high fixed charges, consumers say they cannot "conserve their way to a lower bill." Mt. Prospect Public Forum at 22, (Oct. 8, 2009); Wheaton Public Forum at 29, 36, 61, 64 (Nov. 4, 2009). Consumers also expressed frustration at monthly bills that exceed $60 for as little as 2,000 gallons. Mt. Prospect Public Forum at 22, (Oct. 8, 2009); Wheaton Public Forum at 29, 36, 61, 64 (Nov. 4, 2009). Lax maintenance practices and poor water quality were also mentioned by more than one participant. Mt. Prospect Public Forum at 29 (Oct. 8, 2009); Wheaton Public Forum at 43, 48, 70 (Nov. 4, 2009); Alton Public Forum at 37 (Nov. 9, 2009). (AG Initial Brief at 3-4). In all, 95 consumers and 22 public officials spoke on the record, and many more were present.

Some representative comments are the following:

Randy Kemper, Alton Public Hearing, a customer of Fosterburg Water Company that buys water from IAWC in Zone 1 said:

> "We are talking about a rate increase of 30 percent every three years. Where is that going? That's going beyond anything that anybody increases in their home, in their own budget...And I just see the excess."

Tr. at 38 (Nov. 9, 2009, transcript filed November 24, 2009). In Springfield, James Faron said:

> Last year ... actually, in '08, it [price increase] was 35 percent. This year it's now 47 percent. What business would ever attempt to do that? Other thoughts that came as a private business person -- mismanagement and poor planning."

Tr. At 26 (October 1, 2009, transcript filed October 16, 2009). Nancy Dietrich, a Champaign consumer said:

> "Now, I can't imagine what would happen if a government entity decided to raise its rates on anything by 81 percent, and if this company can't pay for a water treatment plant and cover its expenses with the increase from last year, I think it has a serious problem. Aren't businesses supposed to be more efficient than this?"

Id. at 24.

The AG says despite the fact that IAWC only has 308,000 customers and is a relatively small utility by Illinois standards, the public comment page contained 567 comments as of January 7, 2010. By March 8, 2010, the Commission has received 592 Public Comments in this docket. By contrast, the AG says the Peoples Gas/North Shore rate case, affecting three to four times as many customers, has attracted only 139 comments. The fact that so many members of the public have taken the time to attend public meetings, and call-in or write a Public Comment about IAWC's increase request, the AG argues, should be taken as a strong signal that IAWC's repeated rate increase requests have become excessive. The AG maintains that ~~claims~~ the public is relying on the Commission more than ever to rein in the excessive spending that underlies this Company's rate request. (AG Initial Brief at 4-5)

2. Homer Glen's Position

According to Homer Glen, IAWC currently has water and sewer rates that are far in excess of those charged by surrounding communities. Homer Glen says the proposed increases in this docket would make the differential even higher, further burdening existing ratepayers and putting the municipalities served by IAWC at a disadvantage in attracting new residents and businesses. (Homer Glen Initial Brief at 1)

According to Homer Glen, utility bills are not viewed in a vacuum by ratepayers. Homer Glen says they compare rates with surrounding communities. Homer Glen alleges that when home buyers are looking to purchase, they are becoming aware of the high price for water service in Homer Glen as compared with surrounding communities. In the long run, Homer Glen claims unreasonably high water and sewer rates will drive builders and homeowners away from Homer Glen, creating a cycle where the remaining captive customers of IAWC will pay even higher rates. (Homer Glen Initial Brief at 6)

Homer Glen states that in order for Mokena's residents to pay the same rate as Homer Glen, Mokena would need to increase its rates by 260 percent. For New Lenox, Homer Glen says the increase also would have to be over 200 percent. (Homer Glen Initial Brief at 8)

In Homer Glen's view, what IAWC ignores, however, is the fact that in order for some MOU rates to approach the level charged by IAWC, the municipalities would have to increase their rates by 260 percent. Homer Glen says with IAWC's announced plan of increasing rates every two years, such as the requested 30 percent increase in this case, IAWC's rates will continue to outpace any MOU increase. (Homer Glen Reply Brief at 3)

Homer Glen says the fact that there may be differences between IAWC and MOUs was eliminated by Homer Glen witness Mr. Fundich in his rate comparison analysis. Homer Glen insists that the rate of increase by IAWC far outstrips any increase by MOUs. (Homer Glen Reply Brief at 3-4)

Homer Glen states that IAWC attempts to discredit Mr. Fundrich's conclusion by stating that he did not demonstrate comparability of the respective systems, thus rendering his comparisons meaningless. Homer Glen argues that to the contrary, the Company is the party that has failed to show why its rates are some $117 per month higher than surrounding systems using Lake Michigan water and why the increases have been so staggering. Homer Glen claims that IAWC's Mr. Uffleman, who sponsored the Company's MOU study, when asked whether he studied the operating costs for either the New Lenox or Mokena water utilities, replied, the he has not. Homer Glen asserts that Mr. Uffleman did not even know what percentage IAWC was proposing to increase rates in the Chicago Metro district. (Homer Glen Reply Brief at 4-5)

According to Homer Glen, IAWC erroneously argues that its rates are higher than municipalities because it has extensive regulatory responsibilities related to the drinking water standards (Safe Drinking Water Act (42 U.S.C. §300f et seq.)) and wastewater standards (Clean Water Act (33 U.S.C. §1251 et seq.)). Homer Glen asserts that these are the same standards that must be met by municipally-owned utilities, as IAWC witness Teasley agreed. Homer Glen claims these regulatory requirements are uniform for both IAWC and the surrounding MOUs. Homer Glen says compliance with federally mandated standards should not be more costly for IAWC because it is an IOU. (Homer Glen Reply Brief at 5)

Homer Glen says IAWC then argues that MOUs benefit from the ability to receive contributions in aid of construction from developers who may include the contributions to the MOU in the price of a lot or a home and the purchaser of the lot or home ends up financing the plant contributed by the developer to the MOU as part of their mortgage. According to Homer Glen, this is mere speculation by IAWC and not supported by the record. Homer Glen says it assumes that developers sell homes with line items for each cost of the home such as lumber, concrete, labor, appliances, and the like. Homer Glen asserts that any statements made concerning home builders "marking up" their home prices because of contributions to MOUs is without any factual basis and should be disregarded. (Homer Glen Reply Brief at 5-6)

3. The AG's <u>and Other Municipalities'</u> Position

In addition to the participation in Public Meetings and on the Commission's Public Comment system, the AG <u>cites</u> ~~says~~ testimony ~~was~~ submitted by consumers and municipalities addressing IAWC's already excessively high water and sewer prices. ~~The AG states that~~ In the Chicago Metro District, representatives of Mount Prospect, Des Plaines, and Homer Glen submitted testimony describing the large disparities between IAWC rates and the water rates paid by consumers in their towns or neighboring towns who receive water from the municipalities rather than from IAWC. (AG Initial Brief at 6)

~~The AG states that~~ Mount Prospect Mayor Irvana K. Wilks, who serves on the Northwest Joint Action Water Agency Board, testified that Mount Prospect has both a Village-owned water system and the Illinois American Water system within its boundaries. ~~The AG claims~~ <u>Mayor Wilks testified that</u> she has the unique perspective and ability to compare the two systems and their impacts to our residents. She expressed concern about the negative impact IAWC's "significant increase in rates" will have on the 22% of its residents and the 16% of its commercial and multi-family buildings that are served by IAW. ~~The AG says~~ She testified that she is concerned about the enormous disparity IAW's proposed increase would create between what residents and businesses pay for Village owned water versus what others pay for IAW water. ~~According to the AG,~~ Mayor

Wilks noted that IAWC's proposal would increase the bill of a family that uses 10,000 gallons of water from $46.85 to $67.48, not including purchased water costs. The cost of purchased water adds $11.97 in fixed charges and $2.23 per thousand gallons to the IAWC bill. AG Ex. 7.0. A customer using 10,000 gallons would pay more than $100.00 for water and sewer collection. She testified that her Village charges $4.68 per 1,000 gallons with no additional charges.

~~The AG states~~ Mayor Wilks testified that if the proposed rate increase is allowed, IAWC customers would pay 44% more than Village water customers. Mayor Wilks also expressed concern about how the economic downturn has affected Mount Prospect residents, and stated that it would be very irresponsible and inconsiderate in light of the nation's current economic condition" to impose "such a tremendous rate increase, one that is so disparate among residents and businesses in different areas of town." (AG Initial Brief at 6-7)

The ~~AG indicates the~~ City of Des Plaines also submitted testimony addressing the problems created where some residents receive city water at reasonable rates, while other residents pay the substantially higher IAWC rates. ~~The AG notes that~~ City manager Jason Bajor expressed concern about IAWC's significant increase and the increased burden on residents who are already struggling to make ends meet. Mr. Bajor testified that if the rate increase request is approved, residents within Des Plaines that were in IAWC's service area would pay more than triple of what other Des Plaines residents pay for the same water. ~~The AG says~~ Mr. Bajor described the efforts Des Plaines is making to minimize the burden on residents despite its loss of revenue due to the recession and the increased burdens borne by the city as a result of foreclosures, bankruptcies, and job losses among its residents. (AG Initial Brief at 7) Mr. Bajor explained that the City "has drastically reduced its operating budget by delaying capital improvements such as the construction of new fire and police stations and delaying the purchase of vehicles equipment and other supplies. Top level management received no salary increases. …In spite of the above, the City was still able to maintain its water system and make needed improvements, ;and has included necessary maintenance and improvements to the water system in the 2010 budget."

~~According to the AG,~~ Mr. Bajor testified that in light of its efforts to keep costs and taxes low, Des Plaines was shocked and disheartened to see that IAWC has hired several new employees and has proposed an aggressive capital improvements program, all during a time of continued record unemployment, and increased foreclosures and bankruptcies. ~~The AG says~~ Mr. Bajor concluded that the Commission should require Illinois American Water to exercise the same restraints on increased spending as the City of Des Plaines and every other City and Village in their service area by cutting unnecessary administrative costs, non-essential capital projects, restricting new hiring, and limiting wage and salary increases. (AG Initial Brief at 8)

The AG says if IAWC is granted the entire rate increase it is requesting, some customers will pay $17.00 per gallon for water and wastewater collection services, while other customers who receive water and wastewater collection and treatment will pay $26.00 per gallon, according to materials prepared by IAWC and used at public meetings in the Chicago Metro area. AG Cross Ex. 4 and 5. The AG states that IAWC's Chicago Metro rates are already higher than the rates of neighboring communities and already higher than the penny-a-gallon touted by IAWC's promotional materials. The AG says the rate increase requested in this case, if allowed, will burden consumers who already pay more than is typical in their areas even more. (AG Initial Brief at 10)

The AG states that high water costs have far-reaching consequences that can affect public health, businesses and economic development, and quality of life. The AG says high water charges transfer money and resources out of the community, and burden consumers who may be on fixed incomes, may be facing unemployment, or may otherwise be facing economic challenges. (AG Initial Brief at 10)

According to the AG, IAWC attempts to avoid the effect of consumers' ire at its high rates by arguing that you just can't compare IAWC's rates to local, municipal rates. The AG states that IAWC also incorrectly alleges that parties are attempting to relitigate the issues raised in IAWC's last rate case, where an expert witness for the AG presented a benchmarking study to demonstrate the disparity between IAWC's costs and municipal costs and to calculate an adjustment to bring IAWC's costs into line with industry benchmarks. The AG believes IAWC misses the point of the public participation in this docket, which is to show that consumers and local officials find IAWC's rising rates unreasonable in light of what is commonly paid for water and sewer service in their communities. (AG Reply Brief at 36)

In the AG's view, there is no question that IAWC's rates greatly exceed the rates paid for water by residents of communities adjacent to IAWC's service territory. The AG says these are facts testified to by various witnesses. The AG states that every month when residents in the Chicago Metro area open their bills, they know that they are paying an excessive price for the most basic commodity people consume – clean water. The AG contends it is not surprising that ~~in this case~~ these residents were moved to participate in this case and let the Commission know that they find IAWC's rates unreasonable. (AG Reply Brief at 36-37)

The AG says IAWC relies on expert studies and its accumulation of costs to argue that its rates are reasonable, notwithstanding the experience of its Chicago Metro and other customers. According to the AG, the regulatory process is meant to review a public utility's charges, and public understanding and acceptance are key factors that the Commission should consider. The AG states that when reviewing a utility's request to increase rates by 30%; including a request that charges to an affiliate be increased by more than 22%; that it wants to be allowed to pay its attorneys close to $1 million for an 11-month rate case; that it needs to charge consumers more than 10% to compensate its investors when the public is facing declining pension funds and job losses; that it wants consumers to pay more than $400,000 for a "study" of why its affiliate charges are so high; or that it wants to earn a return on a business practices study costing more than $600,000, the Commission should remember the concerns of the consumers who pay for these costs. The AG says these consumers are looking across the street, and are angry that the same water and sewer services are costing their neighbors less than half what they pay IAWC. (AG Reply Brief at 37)

The AG indicates that IAWC expended time and money to support its argument that one cannot compare municipal rates to IAWC rates. The AG states that nevertheless, people do. The AG says when a certificate of public convenience and necessity is issued, it is on the assumption that the private utility can "furnish, provide, and maintain such service instrumentalities, equipment, and facilities as shall promote the safety, health, comfort, and convenience of its patrons, employees, and public and as shall be in all respects adequate, efficient, just, and reasonable." The AG argues that it is becoming apparent that the certificate to IAWC to provide water and sewer service is resulting in rates that the public finds unreasonable and unjust. (AG Reply Brief at 37-38)

In the AG's view, IAWC's arguments that the Commission cannot compare IAWC to local, municipal water providers are ultimately irrelevant. The AG says if IAWC cannot use its unique economies of scale and corporate resources to offer services at rates that are at least comparable to those of other local water systems, it is doing something wrong. The AG suggests IAWC's goal should not be to find arguments to avoid the obvious comparisons that its consumers are making, but to reduce its rates. Rather than spend close to $2 million on studies and efforts to increase rates, AG suggests it should focus on reducing its rates. The AG claims that only when IAWC reduces its rates will consumers and the public stop comparing its rates to their neighbors' rates. (AG Reply Brief at 38)

4. IAWC's Position

Move language from pages 190-194 of the Proposed Order, Section M.1 to Section M.4, after the discussion of the testimony to which the Company responds.

5. Commission Conclusions

As described above, both the AG and Homer Glen ~~complain~~ rely on testimony, exhibits, and public comments showing that IAWC's rates are higher than surrounding municipally-owned utilities. While IAWC does not dispute the AG's or Homer Glen's assertions, it does argue that direct comparison to MOUs is inappropriate. IAWC attempts to explain why its rates are higher than MOUs and to justify its position that its rates are reasonable.

In Docket No. 07-0507 the Commission found that "Due to the fundamental differences between MOUs and IAWC, it is the opinion of the Commission that a comparison of IAWC's rates and costs to those of MOUs is a very difficult undertaking." (Order at 44) The Commission believes that although it may be difficult to adjust IAWC's costs based on the comparisons of the cost of MOUs and IAWC, we cannot be blind to the fact that these differences exist, and that consumers are very aware of them. ~~conclusion remains true today. While the~~ The Commission understands the concerns of the AG and Homer Glen, and the municipalities and consumers that have participated in this proceeding. The large disparity between what IAWC customers pay for water and sewer services, particularly in the Chicago Metro District, causes us to be especially mindful of the costs that IAWC seeks to include in rates. The double digit increases IAWC has sought in some districts, and the decreases, followed by large increases in other districts (Chicago Waste Water and Lincoln), raise serious questions about the accuracy of IAWC's tracking and presentation of its costs. We are also seriously concerned about the large increases in costs set barely two years ago. Expenses that are increasing at an unusually fast rate will be closely examined to determine if a reasonable person or company would expect or could justify the large increase requested. ~~as a practical matter, the record of this proceeding, combined with the statutory framework within which utility rates are established, provides the Commission with no method whereby these concerns may be fully resolved at this time.~~

~~Regarding other Intervenor issues, in its Reply Brief, page 14, Municipalities Homer Glen et al. refer to "Homer Glen issues [that] are not resolved." These "Homer Glen issues" were addressed by IAWC witnesses, but do not appear to have been addressed by Homer Glen in its Initial Brief. In any event, the Commission takes note that these issues remain unresolved as between Homer Glen and IAWC. The Commission will not make any further determinations on them at this time.~~

In its Initial Brief, pages 26-27, Municipalities Homer Glen et al. state, "The Commission Should Investigate IAWC's Statements that It Provides Water and Wastewater Services 'For Around a Penny a Gallon.'"

In its Reply Brief, pages 110-113, IAWC disagrees. According to IAWC, calculations by the Municipalities combine water and sewer charges; whereas, the language of the communication at issue states that "around a penny a gallon" is what customers pay, respectively, ". . . for a gallon of water delivered to your home, *or* a gallon of wastewater taken away from your home."

~~In any event, while~~ The heading of IAWC's communication at issue could have been more clearly worded, and gives consumers the impression that their rates are lower than they are. The Commission is concerned that notice to the public be accurate, and does not condone the situation where a formal notice accurately states rate increases while a more informal notice, in the nature of an advertisement, misstates rates. When rate notices are required, IAWC must be consistent with all of its materials, even if they do not correspond with the national marketing materials. ~~does not believe the language cited warrants the initiation of a formal investigation into IAWC's advertising policies at this time.~~

EXCEPTION: The Cash Working Capital Calculation In Rate Base Should Be Reduced To Remove The Excessive Revenue Lag and The Premature Payment Of Affiliate Charges In IAWC's Lead-Lag Study.

Cash working capital is an addition to rate base representing the capital or cash required for business operations between the time a service is provided and payment is received. In this docket, IAWC's cash working capital adjustment is based on several assumptions that inflate the amount included in rate base, and in turn push rates up beyond a reasonable level. As discussed above, the large disparity between IAWC's rates and the rates of neighboring systems combined with the substantial increases in rates in 2008 and requested in this docket should lead the Commission to critically assess IAWC's method of calculating its cash working capital adjustment.

The Proposed Order describes several criticisms of IAWC's cash working capital calculation raised by the Illinois Industrial Water Consumers (IIWC) and the AG. To summarize those criticisms, they are (1) the Company overstates the lag between when services are provided and when payment for services is received; (2) the Company improperly uses 2005 for its study, despite the fact that the Company experienced significant billing and collection problems that year; and (3) the Company unfairly charges consumers as a result of IAWC's choice to pay its affiliated Service Company fees in advance. As a result of these accounting choices, IAWC has increased the cash working capital allowance by $4,757,000. A breakdown of this adjustment for each district can be found at AG/JM Ex. 5.1, Sch. B.

The Order in this docket should adopt the cash working capital adjustments proposed by AG/JM witness Ralph Smith and IIWC witness Michael Gorman. IAWC has inflated the rate base and increased its rates by making unreasonable assumptions, using outdated data, and giving preferential treatment to its affiliated Service Company. The Commission should insist on a more reasonably calculated cash working capital allowance, and adopt the adjustments proposed by the AG and IIWC.

Specifically, the Commission should follow the example of the West Virginia Public Utilities Commission which rejected the West Virginia American Water Company's attempt to increase the cash working capital allowance to account for prepayment of affiliated management fees. The West Virginia Commission stated: . It adopted the argument of the state Consumer Advocate Division (CAD) to apply IAWC's 12 day lag for direct payroll to its Service Company payments, and refused to allow the utility to include a payment lag in cash working capital for pre-payment to the affiliated Service Company. The West Virginia PSC stated:

> The Commission is not persuaded that the CAD recommendation is unreasonable or requires actions on the part of the Company that violate its agreement with AWWSC. The agreement allows AWWSC to provide a current bill 'as soon as practicable' after the last day of each month. It also provides that AWWSC provide an estimate of the bill for the next month. However, there is no provision for advance payments of the next monthly bill. While WVAWC should not act unreasonably in making payments to AWWSC, a lag comparable with its own payroll lags does not appear to be unreasonable, while an advance payment does appear to be unreasonable. The Commission will adopt this CAD adjustment to the Cash Working Capital.

AG/JM Ex. 5.0 at 24, quoting Case No. 08-0900-W-42, Order at 35-36 (March 25, 2009)(available at: http://www.psc.state.wv.us/orders/default.htm - search March, 2009).

The same adjustment should be made in this case. .

EXCEPTION III – Proposed Language

The extensive discussion of the parties' positions on cash working capital need not be modified. However, the Commission's Conclusion on page 16 should be amended as follows:

5. Commission Conclusion

As the Commission understands it, IAWC has proposed a cash working capital allowance based, essentially, on the same lead/lag study it presented in Docket No. 07-0507. IAWC has proposed some modifications to that study based upon changes in circumstances since its last rate case and in response to certain complaints of parties in this proceeding. While Staff initially had some concerns with IAWC's proposed CWC calculation during this proceeding, it ultimately accepted IAWC's proposed CWC request. IIWC and the AG have raised several concerns with IAWC's CWC request; those concerns are summarized above and will be addressed below.

IIWC and the AG express concern about the revenue collection lag used by IAWC. They argue that IAWC's lead-lag study assumes ~~assumption means~~ that, on average, its customers pay their bills late, which they believe is an unreasonable assumption and unfairly increases their revenue responsibility. IIWC argues that customers have an incentive to pay their bills on time and it is not reasonable to assume a revenue collection lag greater than the 21 days in which residential customers are allowed to pay their bills. The AG argues that it is not fair to burden all customers with a higher CWC requirement because a few large customers pay their bills late.

IAWC responds that regardless of what the Commission's rules or IAWC's tariffs state, its calculated revenue lag is accurate. IAWC contends that the primary reason its computed revenue lag is so high is that a relatively small number of governmental customers, to which the standard due dates do not apply, have large outstanding bills for relatively long periods of time.

Having reviewed the positions of the parties, the Commission is not convinced that it is appropriate or reasonable to simply charge all consumers for a revenue lag caused by a few large consumers. IAWC has not shown that consumers on average pay their bills late, and it is improper to charge all consumers as if that were the case. We find that IIWC's and the AG's recommendation ~~assume~~ that 21 lag days should be used is reasonable because it is the payment lag ~~number~~ appearing in the Commission's rules. If IAWC is experiencing a long payment lag with certain customers, it should address that problem directly rather seek to recover this cost from all consumers through a rate base adjustment. ~~Also, Section 285.2070 of Part 285 specifically contemplates the use of a lead/lag study. The Commission does not believe that IIWC's assumption regarding customer behavior is consistent with information in the record regarding actual customer behavior. The Commission believes that IAWC has explained why its revenue lag exceeds 21 days. While the Commission understands the AG's fairness concern, the proposal to use 21 revenue lag days ignores what is actually experienced by IAWC. While the Commission might consider a proposal for a different allocation of the CWC responsibility among customer classes in future rate proceedings, it cannot simply ignore a legitimate cost of providing service. The Commission concludes that the Company's proposal is more reasonable than setting the revenue lag days at 21 days, and the 21-day proposal will not be adopted.~~

The next major issue relates to IAWC's prepayments to the Service Company. IIWC and the AG contend that such a practice is inappropriate and causes the CWC requirement to be overstated. IAWC claims that is appropriate for it to prepay for Services Company services and that doing so allows the Service Company to avoid incurring its own CWC requirement, which it claims would be passed on to IAWC anyway. Although IAWC also argues that the Commission-approved Service Company Agreement requires IAWC to prepay for Services Company services neither the Commission's order nor the Service Company Agreement mandates prepayment. In fact, prepayment was not addressed at all by the Commission in its approval of the agreement. See ICC Docket 04-0595 (Oct.19, 2005). ~~Finally, IAWC claims that because the Service Company agreement requires it prepay for services, if the Commission were to make an adjustment to the CWC requirement, it would be denied the opportunity to recover the reasonable cost of providing utility service.~~

The Commission is sensitive to concerns that affiliated interest transactions have the potential to have adverse consequences for ratepayers. ~~It does not appear that in this instance any party is arguing that IAWC's actions are prohibited by the Services Company Agreement. Instead, the argument is that IAWC's CWC requirement could be lowered if it did not prepay for Service Company services. While that argument may be correct as far as it goes, there are other consequences to consider. If~~ IAWC argues that if it did not prepay for Service Company services, the cost would be shifted to the Service Company. Because the Service Company Agreement allows the Service Company to pass its costs directly on to IAWC, Illinois-American could not actually avoid the cost and ratepayers would ultimately be responsible for the costs. We reject this "head-I-win, tails-you-lose" argument. IAWC has an obligation to minimize costs to ratepayers, and the Commission will not approve a procedure like prepayment that increases costs to ratepayers and is neither mandated by the Service Company Agreement nor consistent with industry practice. Most employees are paid after their work is done, and the services provided by the Service Company should not be treated any differently. ~~As a result, the Commission sees no benefit to ratepayers from modifying the CWC requirement to address this concern and the proposal to do so is hereby rejected.~~

As explained above, the AG expresses concern about relying on the 2005 lead/lag study, arguing in part, that there were problems associated with the billing data for the Chicago Metro area in 2005. The Commission notes that the 2005 lead/lag study formed the basis for rates in Docket No. 07-0507. While there may be benefits to having an updated lead/lag study, the record does not contain such a study. In the Commission's view, there is no viable alternative to the using IAWC's lead lag study as the starting point for estimating the CWC requirement. However, we find that the adjustments adopted herein minimize some of the problems associated with using the old data underlying the lead-lag study. The Commission does not believe the record supports rejecting IAWC's lead/lag study.

IIWC ~~and the AG also complain~~ asserts that the lead/lag study does not correctly reflect the transition from bimonthly to monthly billing in the Champaign and Lincoln districts. IAWC provided testimony explaining how its lead/lag study was modified to reflect the transition from bimonthly to monthly billing in those two districts. Based upon its review of the record, the Commission concludes that IAWC has reasonably reflected the transition to monthly billing in the Champaign and Lincoln districts. It appears to the Commission that a further adjustment to the lead/lag study is unnecessary and the proposals to do so are not adopted.

The final area of concern regarding IAWC's lead/lag study relates to the treatment of uncollectibles. IIWC and the AG believe that the lead/lag study should exclude the impact of uncollectibles. As the Commission understands it, IAWC agrees and has modified its lead/lag study to remove the impact of uncollectibles.

As a result of the adjustments we make to the lead-lag study, rate base is reduced by $4,757,000. The allocation of this reduction is shown on AG/JM Exhibit 5.1, Schedule B,

EXCEPTION IV-A: The Cost For Business Systems Planning Study Should Be Rejected As Unnecessary.

The Proposed Order would allow IAWC to charge ratepayers to fund an American Water Works wide "planning" study that will review IAWC's systems and procedures. Proposed Order at 20-21. According to IAWC and the Proposed Order, the study is intended to "satisfy IAWC customer and other stakeholder expectations, and review technology options to support the implementation of automated processes that provide improved service to customers." Proposed Order at 20. No specific needs or specific customer expectations were identified. Further, IAWC claims that the Service Company already provides IAWC with financial, legal, operational, information technology, and other services. See Proposed Order at 29-30. In addition, AG Cross Exhibit 12 showed that the Service Company has already come up with a plan for modernizing certain American Water operations (although IAWC found the cost allocated to Illinois excessive). IAWC has not explained why ratepayers need to fund both Service Company "expertise" and no less than three business consulting firms to provide more expertise to the Company. AG Cross Ex. 21. The cost for this study should be rejected because (1) the cost is excessive and duplicates the work provided by the Service Company; (2) no specific need other than to "upgrade" systems has been identified to justify this cost; (3) ratepayers should not be asked to pay high priced business consultants[8] to prepare a "business study" when rates are already excessive as compared to other systems in the same region providing the same services; (4) it is irresponsible to impose this additional cost on ratepayers in light of the repeated, unusually large rate increases IAWC has sought over the last few years; and (5) increasing rates to fund a "business study" puts an increased burden on ratepayers who are already facing record unemployment, recession, and other economic challenges.

[8] See AG Cross Exhibit 21.

Rather than asking consumers to pay high priced consultants to tell IAWC how to run its business, IAWC should be following the lead of communities like he City of Des Plaines that has limited discretionary expenditures during this economic downturn. DP Ex.1 at 4.

The Proposed Order relates IAWC's comment that no witness recommended that the study be rejected. Proposed Order at 19. Although expert witnesses review accounting treatment, they do not decide what is ultimately reasonable: that is the Commission's job. Further, the Company bears the burden to prove that its costs are just and reasonable,[9] and any party can recommend to the Commission, based on the evidence in the record (even if it is the Company's own evidence) that a cost should be rejected as unreasonable. The business planning study is not a reasonable expense, and IAWC should not be allowed to increase its rate base to charge consumers for it.

Exception IV-B The Record Does Not Support Allocating 16% of the Study Cost to Illinois, Which The Record Shows Only Serves 9% of American Water Company's Customers.

The "business study" should be rejected. However, and only in the alternative if the Commission does not protect consumers from the cost of this study in its entirety, the Commission should not allow the Company to collect the charges for the study as if IAWC represents 16% of American Water Company's customers. The Proposed Order allocates 16% of the study cost to Illinois based on an oral statement made by an IAWC witness that IAWC customers "could be 15,16 percent." See Proposed Order at 19; Tr. at 474. The Commission should not rely on this number. First, the witness was not talking about the business planning study when he suggested the 15, 16 percent number. Second, the 15, 16 percent referred to a subgroup within the Service Company. Third, he admitted at the bottom on the *same page* that he did not know the percentage of

[9] 220 ILCS 5/9-101.

customers represented by IAWC in the particular group being discussed.[10] This vague statement contradicts his statement where he confirmed that Illinois represents 9% of American Water's customers. Tr. 473. The same witness (Edward Grubb) submitted cost allocations in IAWC Ex. 5.02 showing that IAWC was allocated about 9% of total Service Company costs. The evidence does not support allocating to Illinois consumers more than 9% of the costs of the business study, should the Commission allow IAWC to pass any of that cost to consumers.

EXCEPTION IV-A: Proposed Language, Removal of Business Planning Study Cost

The following changes should be made to the Proposed Order to reject IAWC's request to include the Business Planning Study cost in rates. The following changes should be made to the Commission Conclusion on page 20.

B. Business Systems Planning Study

3. Commission Conclusion

The AG objects to IAWC's proposal to include in rate base the costs associated with the Comprehensive Planning Study, $625,240. The AG also suggests that even if the costs are not disallowed in their entirety, IAWC is proposing to recover too large a portion of the costs from Illinois ratepayers.

IAWC argues that the costs associated with the CPS benefit ratepayers and are prudent, but fails to specifically identify how the CPS benefits ratepayers or what specific unmet customer expectations it is intended to address. Although IAWC says no witness claims the costs are excessive, the Commission will assess whether the costs are reasonable and ~~and believes that such costs~~ should be included in rate base after considering the evidence in the record.

~~While the~~ The Commission understands the AG's view that expending money on studies such as the CPS contributes to higher rates ,and that IAWC must show more restraint in seeking to recover such costs from the public,

[10] Q: Do you know what percentage of total customers is located in Illinois? Is it about nine percent? A: About nine percent, yes. Tr. at 473. On the next page the witness discussed why the allocation of costs to Illinois for "division operations support and regulated operations" was higher, and he said that that group was smaller, and he thought that Illinois customers represented a higher percentage of that group. He ultimately did not know, however. Tr. at 474.

particularly during this time of recession and high unemployment. ~~all corporations must plan for the future. The Commission believes that in the long run, customers benefit when utilities engage in such planning. Here, the Company has explained why the CPS is beneficial to customers.~~ The evidentiary record does not support a finding that the cost of the CPS should be ~~dis~~allowed. Based on the services IAWC claims are provided by the Service Company, we believe the study is ~~as~~ duplicative ~~or~~ and unnecessary, and the Commission will ~~not~~ adopt the AG's recommendation to reject it. ~~do so~~.

Delete last paragraph beginning "Regarding the allocation of the CPS cost."

EXCEPTION IV-B: Proposed Language, Allocation of Business Planning Study Cost

The record supports removing the business planning study from rate base. However, if the Commission erroneously allows the company to include some of the cost in rates, the allocation to Illinois should not exceed the proportion of customers IAWC identified in its exhibits.

Accordingly, without waiving the position that no business study costs should be allowed in IAWC's rate base, and in the alternative, the following language is proposed:

3. Commission Conclusion

The AG objects to IAWC's proposal to include in rate base the costs associated with the Comprehensive Planning Study, $625,240. The AG also suggests that even if the costs are not disallowed in their entirety, IAWC is proposing to recover too large a portion of the costs from Illinois ratepayers.

IAWC argues that the costs associated with the CPS benefit ratepayers and are prudent, but fails to specifically identify how the CPS benefits ratepayers or what specific unmet customer expectations it is intended to address. Although IAWC says no witness claims the costs are excessive, the Commission will assess whether the costs are reasonable and ~~and believes that such costs~~ should be included in rate base after considering the evidence in the record.

~~While the~~ The Commission understands the AG's view that expending money on studies such as the CPS contributes to higher rates and that IAWC must show more restraint in seeking to recover such costs from the public, particularly during this time of recession and high unemployment.~~, all corporations must plan for the future. The Commission believes that in the long run, customers benefit when utilities engage in such planning. Here, the Company has explained why the CPS is beneficial to customers.~~ Notwithstanding our concern that this discretionary study will push already high rates yet higher, we will allow IAWC to recover a portion of the study cost it claims. T~~he~~

~~evidentiary record does not support a finding that the cost of the CPS should be disallowed as duplicative or unnecessary, and the Commission will not adopt the AG's recommendation to do so~~.

Regarding the allocation the CPS cost, the costs associated with the CPS "is being allocated to all the regulated entities of American Water based on customer count" according to Mr. Grubb. (IAWC Ex. 5.00R2 at 6) ~~While the record is not entirely clear, Mr. Grubb suggests that Illinois customers make up 9% to 16% of American Water's customers, (Tr. At 473-74),~~ Mr. Grubb provided IAWC Ex. 5.2 showing that IAWC is allocated 9% of the Service Compnay costs. He agreed on cross examination that Illinois represents 9% of American Water's customers .Given that the total cost of the CPS is $2,390,000 (AG Cross Ex. 21), it appears that the AG is correct that an excessive portion of the costs has been allocated to Illinois. Assuming that Illinois' customer count represents ~~16%~~ 9% of the American Water's customer count, IAWC's responsibility would be $215,100 ~~358,652~~ rather than $625,400. Therefore, the Commission concludes that IAWC's rate base should be reduced by $410,300 ~~266,748~~, with each rate district's reduction based upon the respective customer count.

EXCEPTION V – Approved Rate Bases

Section C, Approved Rate Bases should be modified to reflect these changes, as shown in the following proposed language.

EXCEPTION IV: Proposed Language

On page 21, the approved rate bases should be shown as follows, showing the total removal of the business planning study. In addition, to be aware of the change in rate base, the rate base totals from IAWC's last rate case should be displayed.

C. Approved Rate Bases

Upon giving effect to the conclusions above, the approved rate base for IAWC's Rate Zone 1 is $ 437,896,000 ~~441,432,766.~~ The approved rate base for IAWC's Chicago Metro Water district is $ 98,496,000 1~~00,000,575~~. The approved rate base for IAWC's Chicago Metro sewer district is $ 45,558,000 ~~45,829,534.~~ The approved rate base for IAWC's Pekin district is $ 16,267,000

~~16,396,051~~ and for its Lincoln district is $ 9,104,000 ~~9,202,926~~. This compares with IAWC's rate base in its last case as follows:

District	Docket 07-0507 Rate Base	Docket 09-0319 Rate Base
Zone 1	$391,644,267 App. A, D, E,	$ 437,896,000
Chicago Metro Water	$79,530,725	$ 98,496,000
Chicago Metro Sewer	$37,209,773	$ 45,558,000
Pekin	$15,468,356	$ 16,267,000
Lincoln	$8,242,042	$ 9,104,000

EXCEPTION V: The Excessive Increase In Service Company Fees Show That IAWC Is Not Controlling Its Costs And Should Be Rejected.

The Proposed Order would allow IAWC to recover from ratepayers a 19.36% increase in identified Service Company fees over only 18 months (June 30, 2009 to December 31, 2010).[11] The Proposed Order adds that the Commission "is not unmindful of continuing concerns over IAWC Service Company expenses," Proposed Order at 46, and orders the Company to "file a detailed estimate or estimated range of such costs within 60 days after entry of this order. Other parties shall be given the opportunity to make such a filing if they chose to." Proposed Order at 47. This is not an appropriate response to the unreasonable costs IAWC is placing on consumers.

The Commission should act on "continuing concerns" over these escalating, affiliate costs by rejecting the large cost increase IAWC is seeking in this case. The Commission has the power and the responsibility to reject cost increases that are unreasonable, and the Company will only have an incentive to keep these costs down if it

[11] The total amount of service Company fees allowed by the Proposed Order is $20,591,234 which is 19.36% higher than the $17,251,000 allowed in Docket 07-0507.

believes the Commission will reject these over-sized requests. Further studies or reports predictably result in huge consultant fees to provide studies to justify the Company's position and impose impossible burdens on Staff and intervenors to micro-manage the Company's operations. It is not the Commission's role, or intervenors' role, to comb through every one of IAWC's claimed management expenses and determine which should be approved. The regulatory compact requires that the Commission approve a reasonable cost level, and give the Company the opportunity to manage its operations within that cost level. An itemization of expenses does not make excessive costs reasonable.

The increase IAWC seeks is on top of an increase of 170% in Docket 07-0507 over the Docket 02-0690 expense. Moreover, the Management Fee increase is understated because it does not reflect that IAWC has reassigned substantial functions away from the Service Company, so IAWC is paying more for less. If the same functions that were included in Docket 07-0507 were compared to this docket, so that an "apples to apples" comparison could be made, the increase to the Service Company charge made in IAWC's supplemental testimony would be at least $1,389,492 rather than $544,823. Proposed Order at 33. The steady pace of double and triple digit increases for affiliated services demonstrates a lack of reasonable management constraint and requires the Commission to reject these unreasonable increases.

IAWC claims that the Service Company provides efficiencies that enable IAWC to reduce costs compared to either using third parties or hiring its own employees. It has identified numerous claimed efficiencies, such as a national supply chain system, a national call center, a national lab, that smaller, municipal utilities do not have. Tr. at

162-166. Yet, taking IAWC at its word and assuming these many Service Company efficiencies, IAWC consumers pay two to three times more for water and sewer service than neighboring consumers pay for the same services. Increasing Service Company costs are not resulting in cost efficiencies that translate into lower rates for consumers. The Commission should reject IAWC's request to raise management costs and prices yet again in the absence of any positive effect on rates.

Questioning whether IAWC was doing enough to control its costs and in an effort to assess the Management Fee, in its last IAWC rate order the Commission ordered IAWC to "compar[e] the cost of each service obtained from the Service Company to the costs of such services had they been obtained through competitive bidding on the open market." Docket 07-0507, Order at 30-31 (July 30, 2008). The Proposed Order erroneously accepts the studies submitted by IAWC in response to this directive. Both the AG and the Village of Homer Glen objected to the studies because they were essentially tautologies. The Study was not a proxy for competitive bidding because its structure removed key variables that non-affiliated vendors might modify to reduce their costs and their prices. The Service Company and IAWC provided the number of hours billed for each service category as well as the distribution of those hours among different levels of education and experience. Tr. 375, 377-378 (Dec. 9, 2009). The study then simply applied the hourly rates derived from various market surveys. IAWC Ex. 11.01 at 10. The Study did not consider the possibility that a non-affiliated provider could provide the same services for fewer billed hours than the affiliated Service Company, at a lower or different hourly rate, at a different rate structure, with a different distribution of experience and hourly charges, at a fixed fee, or any other number of variables that competitors may devise to obtain business and achieve efficiencies. See AG Initial Brief at 44-46. The Commission should find that the Service Company study and the self-provisioning study are not responsive to the Commission's direction and do not justify the high Management Fees or the increased in costs requested in this docket.

The Proposed Order describes the parties' position, including the position of the AG. In summary, the AG supported its argument that the Service Company cost is excessive and should either not be increased, or increased by no more than 5% as follows:

1. Although in the past IAWC justified increased Service Company costs by citing reductions in IAWC employees, in this docket IAWC has increased authorized employees from 473 in December, 2008 to 510. Further, IAWC President Teasley stated that IAWC is bringing more jobs into IAWC "to increase the state-level focus of its management structure" and testified that IAWC direct employees perform some of the same functions as the Service Company performs. Proposed Order at 32-33, 44.

2. The increase sought in this docket shows a lack of fiscal discipline. First, IAWC was allowed the entire amount it requested for Service Company fees in its last rate case (less incentive compensation), and one would expect the Company to work to stay within that (substantially increased) budget. Instead, IAWC asks to increase that budget by 22.5%. Further, the record shows that the Service Company cost either decreased or showed less than a 5% increase from 2007 to 2009, in contrast to IAWC's claims in this docket to increase charges by 22.5% from the June 30, 2009 test year. If the cost of services transferred out of the

Management Fee were included, the cost would be even higher. This does not show fiscal or budget discipline. Proposed Order at 33-35.

3. Other state commissions have expressed concern about the growth of Service Company fees, with California and Tennessee recently addressing the lack of explanation for the increased costs. Proposed Order at 36.
4. The record contains examples of inefficiencies caused by the added bureaucracy associated with having an outside, albeit affiliated, company provide services to IAWC, such as lack of communication, outsized and overly expensive projects, and questionable costs. Proposed Order at 36-37. The layers of management utilized by IAWC, and paid for by consumers, are substantial and should not increase.
5. IAWC was unable to explain why it failed to allocate *any* Service Company costs to its wastewater operations despite its admission that sewer service presents "some of the greatest challenges." This lack of allocation casts doubt on the accuracy of the Service Company accounting and cost allocations and on IAWC's claim that IAWC "takes affirmative steps to both monitor and control" Service Company costs.[12] Proposed Order at 37-38.

IAWC has not justified increasing the Management Fee cost by 22.5%, by 19.36% or any other amount for the short period between the last test year and the test year in this docket. A double digit increase in management costs, when we are in a period of low if not negative inflation and when literally hundreds of people have complained to the Commission that IAWC's rates are already excessive and unreasonable, should be rejected. Although IAWC claims it does a "bottom up" budget, IAWC's job is to

[12] The Proposed Order describes IAWC's purported cost control at pages 31-32.

provide water and sewer service, and it has not identified any single reason or "driver" for this huge increase. Its claims that it and its affiliate "expend a great deal of effort on controlling costs and promoting efficiencies" (Proposed Order at 32) ring hollow in light of the steady march toward higher and higher rates.

Exception V: Proposed Language to Eliminate the Increase In Management Fees.

The following proposed language modifies some of the discussion of the AG's position and changes the Commission Conclusion to eliminate the increase in Management Fee. In the alternative, without waiving the position that no increase should be allowed, language to allow a 5% increase over the Docket 07-0507 management fee cost is also provided. The discussion of the AG's Position starts on page 32.

2. The AG's Position

In Section III.A of its Initial Brief, the AG argues that "the Commission should reject the 22.5% increase in management fees in less than 12 Months." (AG Initial Brief at 19) IAWC has asked the Commission to include in rates $21,167,057 (excluding incentive compensation) that it claims it will pay to its affiliated Service Company in the 2010 test year. (AG brief at 19-20) The AG claims this amount is 22.5% more than the $17.251 million (excluding incentive compensation) it was allowed to include in rates for the test year ending June 30, 2009 in IAWC last rate case, Docket No. 07-0507. (AG/JM Ex. 5.0 at 49) In Docket No. 07-0507 the management fee expense increased $11,681,000, or about 170%, from the $6,843,000 IAWC recovered in management fees in its prior rate case. These cost increases cover management services that are not provided by IAWC personnel who actually operate the utility on a day-to-day basis. (Tr. 95)

In Section III.A.1, the AG argues, "The Commission should not allow IAWC to recover expenses for both an increased number of IAWC employees and an increased management fee expense." (AG Initial Brief at 20) In its last rate case, the AG asserts, the Commission accepted IAWC's argument that the increase in management fees was justified by "an organizational restructuring in 2004 that ultiately eliminated 31 positions from the payroll of IAWC." (Docket No.

07-0507, Order at 30) However, in this docket, IAWC's payroll shows a consistent increase since February, 2007, after which the actual number of employees rose from 435 to 486 in December, 2008, IAWC Sch. C-11.2a, and the number of authorized employees rose from 446 to 473. (IAWC Sch. C-11.2b) In the 2010 test year IAWC is asking the Commission to further increase the number of IAWC direct employees to 510. (Tr. at 75-76, 78-79) In addition, the payroll expense and the costs of employee benefits are also increasing. (IAWC Sch. C-11.3 and G-10) Unlike the situation in Docket No. 07-0507 where there was a decrease in IAWC employees, in this docket IAWC claims both an increase in direct employees and a 22.5% increase in the Service Company expense. To the AG, it does not appear that Service Company employees are replacing IAWC employees or are performing work otherwise performed by IAWC employees. (AG Initial Brief at 20)

In testimony, IAWC witnesses produced extensive lists of services provided by the Service Company. IAWC direct employees, however, handle the actual operation of the utility. IAWC President Karla Teasley testified that:

> Illinois-American Water employees are directly involved in the day-to-day operations . . . they provide support in the distribution operations area, in the production area. They are in the field providing day-to-day contact and service to customers every day. . . . the people that run the plants, the people that fix the main breaks, the people that read the meters, the people that provide, you know, some maintenance to the facilities, all of the kind of hands-on day-to-day work that we do to keep the water flowing is provided by Illinois-American Water employees. (Tr. at 95-96)

Ms. Teasley also testified that there are IAWC employees who are responsible for engineering, planning, design, overseeing construction projects and overseeing the capital program, as well as finance and communications and external affairs. (Tr. at 96-97) Yet, the AG emphasizes that ~~complains~~, IAWC seeks to include in rates more than $20 million for its Service Company to provide the same management and business services.

The Service Company expense would have been even higher except for amounts for customer accounting and miscellaneous expenses are now accounted for under those expenses that were previously budgeted as service company fees. (AG Initial Brief at 21, citing Tr. at 435) Although Mr. Kerckhove's exhibit 6.02 Supp. shows that as of the filing of IAWC Exhibit 6.00 Supp., IAWC added $821,952 to Customer Accounting and $22,717 to Miscellaneous. If these expenses had not been moved from the Service Company charge, the $544,823 Supplemental increase to the Service Company expense would have been $1,389,492. To eliminate the increases included in IAWC's supplemental testimony, the Commission would have to remove $1,389,492 from the requested Service Company account.

In Section III.A.2 of its Initial Brief, the AG argues, "The excessive and repeated increases in the Service Company expense demonstrate that IAWC and the Service Company have failed to exercise fiscal discipline." (AG Initial Brief at 22) The AG says the following table, taken from IAWC Schedule G-1, shows the actual, the planned (or budgeted), and the December 31, 2010 test year level of Management Fees, also known as Service Company or Business Support Services:

Table 1 - Service Company Costs

	Actual	Change from Prior Year	Plan (or Budget)	Change from Prior Year
Dec. 2007	20,093,161		19,278,490	
Dec. 2008	20,248,278	0.77%	19,046,511	(1.2%)
Dec. 2009	n/a		20,121,164	5.6%
Test Yr - Dec. 2010 IAWC Sch. G-5 First Revised, p. 8	n/a		22,560,025	12.1%

For the for 2010 test year, IAWC first budgeted a 9.4% increase from 2009, and a few months later increased its budgeted cost by $544,000, raising the amount requested in rates to 12.1% over the budgeted 2009 amount. In the AG's view, the ultimate increase claimed in the test year is exorbitant compared to the increases/decreases of the prior years, and are even worse when compared to the June 30, 2009 test year amount in Docket No. 07-0507. (AG Initial Brief at 23) When incentive compensation is removed from the June 30, 2009 and the December 31, 2010 test years, the increase from the last case is 22.5%. (AG/JM Ex. 5.0 at 49)

The test year increases, which are so much higher than the Company's actual and planned increases in prior years, coupled with the increase in IAWC employees, demonstrate that IAWC has not been able to realize savings or economies from the use of the Service Company. (IAWC Initial Brief at 23) On page 30 of its Order in Docket No. 07-0507, the Commission stated, in part:

> If IAWC plans to continue to utilize the Service Company because doing so arguably benefits ratepayers by reducing IAWC's labor and other related costs, then at some point the lower costs must be more evident. Based on the evidence, the Commission adopts the management expense as recommended by IAWC. The Commission, however, has a continuing obligation to ensure just and reasonable rates.

In order to ensure just and reasonable rates, the AG argues, the Commission should deny IAWC any increase in the test year Service Company expense. In the AG's view, the Company has not explained why the cost for these services has increased 22.5% compared to the last test year, and has failed to show that this increase is prudent, reasonable, or necessary. The AG finds this increase particularly troubling in light of both the burden consumers are facing due to high unemployment, foreclosures, and the recession; the efforts local governments have made to keep costs low such as layoffs and salary freezes; and the much lower 4.37% increase for the same services between December 2007 and December 2009. A Service Company expense of $17,251,000 (rather than the $21,136,000 requested by the Company) would increase IAWC's operating income by ~~$3,885,000.~~ $1,884,000 (Erratum, AG Initial Brief, at 24)

In the alternative, if the Commission will not maintain the Service Company charge at the level allowed in Docket No. 07-0507, AG/JM witness Ralph Smith recommended that the Service Company expense be increased by no more than 5% over the $17.251 million test year expense in Docket No. 07-0507, resulting in an adjustment of $3.022 million to the Service Company expense. (AG/JM Ex. 5.0 at 50) This adjustment removes incentive compensation from both the June 30, 2009 test year and the December 31, 2010 test year, and, in the AG's opinion, is consistent with the growth of this expense reported in IAWC Schedule G-1 and in the table above.

Section III.A.3 of the AG's Initial Brief is titled, "Other States Have Been Troubled By The Increase in Management Fees Claimed By AWWC's Regulated Operating Companies." (AG Initial Brief at 24-26) The Service Company to which IAWC pays the Service Company (or Management or Business Support Services) fee also provides services to other states. (Tr. at 367) In a recent California-American water rate case, the AG says the California PUC allowed substantial reductions in California-American's Service Company and General Office expenses. In the instant case, Docket No. 09-0319, administrative notice was taken of the California Public Utilities Commission's decisions in regard to California American Water Company, and the decisions were filed on e-Docket on December 10, 2009 as IAWC-AG Admin. Notice Doc 1.

In the California PUC's Final Decision No. 09-07-021, the Commission referred to being "[c]onfronted with 'seemingly endless' increases in administrative costs," and noted that in Cal-Am's last rate case, the CPUC approved a settlement that included an audit of Cal-Am by the Division of Ratepayer Advocate ("DRA"). (IAWC–AG Admin. Notice Doc 1 (Part 1) at 94, 95) The CPUC noted that the DRA made 14 specific proposals to Cal-Am's General Office charge and adopted $3.2 million in adjustments. The specific adjustments, including nine that relate to the Service Company, are summarized on Appendix C to the order, which is found in IAWC-AG Admin. Notice Doc 1, Part 3. In its final order, the CPUC allowed Cal-Am to file a Petition to Modify the

Order provided it “fully discloses all non-regulated operations which use any assets or employees included in revenue requirement.” On rehearing, Cal-Am satisfied the DRA that some of its allocations were in fact supported, and the DRA agreed to allow $7,454,286 of Service Company allocations into rates. (IAWC–AG Admin. Notice Doc 3) The AG says the other adjustments on Appendix C to the Order were not affected.

In addition to California, the Tennessee Regulatory Authority, in reviewing a Tennessee-American Water Company docket, also addressed the issue of escalating management fees. Although it had ordered an audit of the fees, it found that the audit conducted by the Company-retained expert was not independent and “did not address the primary concerns of the Authority that the costs were the results of prudent management decisions.” (In re Tennessee American Water Company, Docket No. 08-00039, Order at 21-22, January 13, 2009) The Tennessee Regulatory Authority ordered Tennessee American to issue an RFP for:

> . . . a comprehensive audit by an independent certified public accountant. The RFP for the audit shall include, but not be limited to, an investigation of AWWSC’s management performance and decisions . . . and evaluate and attest to the charges allocated to TAWC, including the efficiency of processes and/or functions performed on behalf of TAWC, as well as the accuracy and reasonableness of the allocation factors utilized.

According to the AG, these orders, by sister PUCs, demonstrate that the problem with escalating Service Company charges is not unique to Illinois. Although the Commission in IAWC’s last rate case did order a study of Service Company costs, the study produced (like in Tennessee) was not independent and does not provide the Commission or the public with any ways to restrain the growth of these charges. In addition to disallowing Service Company charge increases, which provides the appropriate incentive to IAWC to control that cost, the AG suggests the Commission “may wish” to order that an independent audit of AWWSC fees to IAWC be conducted, under the direction of the Commission Staff or the Office of the Attorney General. (AG Initial Brief at 26)

The next sub-section of Section III.A of the AG’s Initial Brief is titled, “The Record Shows Poor Service Company Services and Unwarranted Costs.” (AG Initial Brief at 26-28) In response to an AG data request, IAWC identified several instances where IAWC challenged Service Company charges and/or practices. As these examples show, the layers of management provided by the Service Company can add unwarranted costs and complexity to address a specific problem. Four examples are:

AG Cross Exhibits 8 and 9: Service Company engineering did not keep IAWC apprised of plans for Illinois plant. IAWC Director of Engineering Jeffrey

Kaiser contacted the Service Company on June 3, 2008, shortly after he was hired by IAWC because neither he nor the Illinois head of production were informed of an RFP for an Illinois project. The response, almost two months later (July 29, 2008), finally provides a draft scope of work for Illinois review, and schedules a meeting for the end of August for Service Company people to come to Illinois. As shown in AG Cross Exhibit 9, Mr. Kaiser appropriately objected to paying for travel for six Service Company people to spend four days in Illinois, and the number of Service Company representatives was cut to "three or four at the most."

AG Cross Exhibit 10: The Service Company charged fees to a closed Champaign District project. It was unclear why the charges were posted to the closed project. The e-mail says that "they are not Illinois engineers, and do not report to anyone in our office . . . . Of the eight names, Brent O'Neil did not even recognize at least three of them."

AG Cross Exhibit 12: In July, 2008, Cheryl Norton, hired by IAWC on December 31, 2007, expressed concern that a project that had been ordered more than 14 months earlier was "very complex" and "very costly." She noted that IAWC personnel "had not participated in creating the business requirements" and that the scope of the project was much larger than Illinois needed. Ms. Norton had to protest the allocation of costs to Illinois, saying:

> I don't have a problem paying for Illinois' portion of this, however, there was a substantial amount of time spent creating this for the enterprise and then removing those references. I find it very difficult absorbing the entire amount when this project never should have been so unrealistic. We depend on your department to be the experts and create workable solutions for our regulatory requirements. The original project was so far out of scope that it never should have been developed or considered."

Customer Service Outages, Summer 2008: Ms. Norton also complained to the Service Company about problems with the customer service function. She testified that there were at least two telephone service outages in the summer of 2008, during which customers could not get through to the Company's customer service line. (Tr. at 246) She sent an e-mail saying that "this seems to be happening more and more frequently. That may not be the case, but I know it has happened numerous times in the past few months." (Tr. at 248) Notwithstanding these problems, IAWC was not given a credit or rebate from the Service Company as compensation for poor service. (Tr. at 247)

According to the AG, these examples show that the Commission cannot allow IAWC to include an inflated Service Company expense in rates. Close review to protect consumers from inappropriate services and costs, and limiting the amount that can be included in rates, will provide IAWC with the appropriate incentive to keep these costs from spiraling out of control. The AG says the Commission and IAWC should heed the statement by the Hewitt U.S. Salary Increase Survey, Survey Findings: 2009 and 2010 at page vii: "2010 will not be a year with loose purse strings." (AG Initial Brief at 28, citing AG/JM Ex. 5.0 at 50)

The final subsection of Section III.A of the AG's Initial Brief is titled, "The Lack of Allocation of Management Fees to the Chicago Waste Water District Calls Into Question The Accuracy of The Management Fee and Its Allocation." (AG Initial Brief at 28-29)

In reviewing the Service Company charges, AG/JM witness Ralph Smith noted that there was no allocation of these charges to the Chicago Wastewater District. (AG/JM Ex. 1.0 at 50) Neither IAWC President Karla Teasley nor Paul Herbert, who prepared the cost of service studies, was able to explain the absence of an allocation. Although Ms. Teasley later attempted to suggest that applying Service Company costs to wastewater would somehow result in "double-counting" for customers who take both water and wastewater services, Tr. at 175-175, that argument should be discounted in light of her statements on pages 130-132 about the use of the Service Company services for wastewater customer service, billing, IT, and planning. In connection with planning, Ms. Teasley testified that "some of the greatest challenges" are in the wastewater area. (Tr. at 131)

In the AG's view, the lack of allocation to wastewater calls into question the accuracy of the Service Company allocations in general. Clearly there are services that wastewater customers require that are provided through the Service Company, but those costs are not being correctly allocated to that district. In light of IAWC's high wastewater treatment costs, the AG asserts, one may suspect that this lack of allocation was done to try to limit the size of those costs, albeit to the detriment of water customers. (AG Initial Brief at 29)

In the AG's Reply Brief, Section III.G, the AG further argues that IAWC has failed to justify the escalating management fees it seeks. (AG Reply Brief at 23-27) A mere listing of categories of business needs does not justify the level of costs IAWC seeks to charge ratepayers, in the AG's view. (AG Reply Brief at 26) IAWC asserts that no witness has questioned the need for these services. But in the AG's opinion, the "need" for these categories of service is not the question. The question is: are the cost levels and the repeated, substantial escalation of these cost levels over the last several rate cases reasonable and prudent. The AG also contends that IAWC's "detailed budget" does not provide anything other than a break-out of cost categories.

In Section III.B.10 of the AG's Reply Brief, the AG argues that Mr. Smith did not "arbitrarily" reduce the Management Fee. He testified that a 5% increase was "perhaps somewhat overly generous" in light of low salary increases since

IAWC's last rate case and low inflation. (AG/JM Ex. 5.0 at 50-51) In addition, the AG asserts, the 5% figure is consistent with the actual fluctuation in Management Fees between rate cases shown on IAWC Sch. G-1 (Comparison of Prior Forecasts to Actual Data, line 14). (AG Reply Brief at 27)

The Commission Conclusion on page 45-47 should be amended as follows:

6. Commission Conclusion

IAWC uses its affiliated Service Company to provide numerous services. The terms related to IAWC's use of and charges for services provided by the Service Company are set out in the Services Company Agreement previously approved by the Commission. Under the Service Company Agreement, the Service Company provides services for IAWC at the Service Company's cost, i.e., with no profit component. <u>However, overhead costs are loaded into the cost.</u>

The Company ~~'s requested level of expense in this docket,~~ <u>has requested</u> $21.167 million excluding incentive compensation, <u>reflecting a 22.5% increase over</u> the cost of the services IAWC is projected to receive from the Service Company in the 2010 test year <u>compared to IAWC's last rate case</u>.

In its Order in IAWC's last rate case in Docket No. 07-0507, the Commission stated on pages 30-31:

> Because the Commission questions whether IWAC is doing everything possible to ensure low costs for ratepayers, the Commission directs IAWC to conduct a study comparing the cost of each service obtained from the Service Company to the costs of such services had they been obtained through competitive bidding on the open market. As part of the study, IAWC must also provide an analysis of the services provided by the Service Company to all of IAWC's affiliates. The analysis must provide details on the specific services provided to IAWC and how costs are allocated among affiliates of IAWC. IAWC shall include the study in its next rate filing.

As explained in some detail above, IAWC asserts that it met this requirement through a set of studies and the testimony of five witnesses. This evidence purportedly shows that for those services that (1) IAWC obtains from the Service Company; and (2) can be obtained from an affiliate or non-affiliate source, the amount paid by IAWC to the Service Company is well below the cost that IAWC would be required to pay a non-affiliate provider based on market prices for services.

Intervenors AG, Homer Glen et al. (Joint Municipalities) and the Village of Bolingbrook take issue with IAWC's request.

They view the 22.5% increase in the amount allowed in the last rate case, for the test year ending June 30, 2009, as excessive. The AG also states that for the 2010 test year, IAWC first budgeted a 9.4% increase from 2009, and a few months later increased its budgeted cost by approximately $544,000, raising the amount requested in rates to 12.1% over the budgeted 2009 amount. The AG also pointed out that IAWC no longer includes some costs that had been included in the Management Fee, and when those costs are included, IAWC raised the cost of services previously included in the Management Fee expense by $1,389,492 rather than $544,000.

These Intervenors also assert, through arguments of counsel, that the Company's Service Company cost study did not comply with the directive in the Order in Docket No. 07-0507. On this issue, the Commission finds that the studies performed by IAWC are inadequate. It is apparent that both the self provisioning study and the Service Company study assume the same number of hours to provide the same number of services IAWC already receives. There were no variables in the studies to allow for cost reductions or efficiencies and no recommendations about how to limit or reduce costs. We are in the same position as the Tennessee Commission, which found that the Company retained expert was not independent and did not evaluate where cost savings or efficiencies could be found. In re Tennessee American Water Co., Docket 08-0039, Order at 21-22 (Jan. 13, 2009). ~~represent a reasonable effort to comply with the directive of the Commission. Whether IAWC's analysis makes the proper cost comparisons contemplated in the Order is not solely a legal question, and references by Municipalities, Bolingbrook and the AG to competitive bidding procedures applicable to municipalities do not make it so. Rather, the issue involves, at least in part, questions of fact, and in that regard the conclusions of those Intervenors are not supported by evidence of record. Further, from a practical standpoint, it is difficult to see how IAWC could have responded in the manner suggested by those Intervenors, and it does not appear that any such arguments by Intervenors were supported by witness testimony.~~

With respect to the magnitude of the expenses, the AG and Municipalities raise concerns about the level and timing of increases in Service Company fees in the test year. In that regard, the AG recommended no increase in this cost item in light of low inflation, the shift of services and employees to IAWC, and the high rates that consumers find unreasonable in relation to the rates paid by their neighbors who are not IAWC customers. Alternatively, AG/JM witness Smith recommended that the fees allowed be limited to 5% over the amount approved in Docket No. 07-0507. According to the AG, the 5% figure is consistent with the actual fluctuation in Management Fees between rate cases.

As explained by the Commission in prior cases (e.g. Docket No. 02-0690), a test year is intended to be a representative period. Where there have been wide fluctuations in an expense item, the amount projected for the test year may not be fully representative of a normal year. Such concerns may be present when, as in the instant case, the forecasted test year expense or degree of increase is considerably higher than prior years, particularly where the test year expense also reflects large increases in the amount originally budgeted, and the expense item is one for which the Commission previously questioned the Company's efforts to ensure low costs.

Based on its review of the record, the Commission believes that IAWC has not justified the increases it requests in this cost item. There are only six months between the last test year and this test year, and yet IAWC seeks a 22.5% increase in management fees. Further we believe that the increase requested by IAWC in Supplemental Testimony, only a few months after the case was filed, show an unreasonable fluctuation in cost, aggravated by the transfer of certain costs out of the Management Fee category (which tends to make the increase look smaller. ~~the amount initially budgeted by IAWC for the Service Company fees for 2010, before subsequently increasing that amount by approximately $544,000, would be a reasonably representative and normal test year amount for Service Company fees, and is otherwise appropriate for purposes of setting rates in this proceeding.~~

On this issue, the Commission is ~~not un~~ mindful of continuing concerns over IAWC Service Company expenses. The record in this docket demonstrates that despite low inflation, the short time between rate cases, economic recession, already high Management Fees, and already high rates compared to neighboring systems, IAWC has not restrained the amount it is asking consumers to pay its affiliated company. While other businesses and municipal water and sewer operators are exercising fiscal restraint, IAWC has allowed this expense to increase at an unreasonable rate. IAWC's itemization of its expenses does not make the increase it requests reasonable. In light of the shift from Service Company focused management to an operating company focused management, the increase in operating company employees and functions, and the transfer of services out of the Service Company expense and into stand-alone expenses such as "customer accounting" and "miscellaneous", we find that the record fully supports keeping the Service Company Management Fee at the level set in the last rate case, which covered a test year ending only six months before the test year in this case began. In fact, given the reorganization evidently occurring, keeping the Service Company fee at the same level is effectively an increase, because ratepayers are getting fewer services for the same amount of money. ~~The Commission, however, is ultimately required to base its findings on actual evidence of record. In this case, subject to the adjustment adopted above, the evidence presented supports a finding that the Service Company fees approved in this Order are reasonable and should be included in revenue requirement to be recovered through rates.~~

As discussed above, Municipalities urge the Commission to order that an independent audit of the Service Company's fees be performed, and that such cost be borne by IAWC with no recovery of it from ratepayers. The AG suggests the Commission may want to consider ordering such an audit.

IAWC opposes such an audit as lacking any incremental benefit. Moreover, IAWC argues, the Municipalities' suggestion that the cost of this study be borne by the utility is inconsistent with language in Section 8-102 of the Public Utilities Act stating such costs "shall be recovered as an expense through normal ratemaking procedures."

The Commission believes it is possible that an independent audit could be of benefit in evaluating the Service Company fees assessed to IAWC. However, in light of the lack of useful information in studies commissioned by IAWC or other American Water Companies to date and the burden placed on the Staff and on the parties to decipher and analyze such studies, we decline to order another study or audit. Instead, we rely on our decision to cap this expense to provide IAWC with the incentive to more prudently and reasonably incur Service Company fees in the future. ~~Whether such an audit would be cost-beneficial, however, is not determinable at this time, as the cost of such an undertaking is unknown. As such, ordering such an audit in this Order would be premature. Therefore, the Commission finds that IAWC should be ordered to file a detailed estimate or estimated range of such costs within 60 days after entry of this order. Other parties shall be given the opportunity to make such a filing if they choose to.~~

EXCEPTION VI: In This Time Of Recession And Low To Negative Inflation, The Commission Should Reject An Inflation Factor of 1.7% For Non-Labor Expenses.

The Proposed Order allows IAWC to increase costs by a 1.7% non-labor inflation factor. Proposed Order at 55-56. The Commission should remove this inflation factor in light of the Bureau of Labor Statistics report that the 2009Consumer Price Index (CPI) for all items was *negative 0.2%*. AG Cross Ex. 16. The Proposed Order relies on the CPI for all items less food and energy to justify the 1.7% inflation factor used by the Company. However, it does not explain why it is more reasonable to reject the comprehensive CPI in favor of the CPI less food and energy, particularly when water is a key input in food preparation and energy is a key input in water treatment and delivery.

The Proposed Order recites IAWC's testimony that that the Bureau of Labor Statistics reported the CPI for a ten month period as 2.3%. Proposed Order at 56. However, the record contains the most recent Bureau of Labor Statistics CPI report (as of the date of hearings) and it shows the most recent CPI rate to be negative 0.2%. IAWC's witness's statement about what the Bureau of Labor Statistics reported should not be accepted when the actual Bureau of Labor Statistics report was in the record.

EXCEPTION VI: Proposed Language to Remove Non-Labor Inflation Factor

The paragraph entitled Commission Conclusion on page 56 should be modified as follows:

3. Commission Conclusion

The Commission has reviewed the parties' arguments, as well as the information in the record regarding inflation. As noted above, the AG urges the Commission to eliminate, from test-year expenses, the non-labor inflation adjustment proposed by IAWC.

Page 1 of the Livingston Survey shows CPI inflation declining at an annual rate of 0.7 percent from 2008 to 2009 but increasing at annual rate of 1.7 percent from 2009 to 2010. The text of the Livingston Survey does not discuss the forecasts of inflation from 2008 to 2009, which is not surprising given that actual data is available. We do not rely on the Livingston Survey, however, because the CPI as reported by the Bureau of Labor Statistics is in the record. ~~The Commission believes that the Livingston Survey supports IAWC's inflation estimate rather than the AG's.~~

Turning to AG Cross Ex. 16, ~~the AG is correct that~~ the percentage change in CPI, for all items, for the 12 months ended October 2009 is negative 0.2 percent. IAWC urges that we consider that page 3 of that same Exhibit, ~~however,~~ shows that the change in CPI for all items less food and energy for the 12 months ended October 2009 is positive 1.7 percent. Additionally, the change in CPI for commodities less food and energy commodities for the 12 months ended October 2009 is positive 2.3 percent. IAWC did not provide a reason to use the latter measures rather than the negative CPI for all items.

IAWC witness Mr. Kerckhove testified that according to the U. S. Government's Bureau of Labor Statistics, the CPI for the 10 months ended October 31, 2009, is 2.3%. He also testified that according to the U. S. Government's Bureau of Labor Statistics, the PPI for the 10 months ended October 31, 2009, is 2.6%. (IAWC Ex. 6.00SR at 26-27) However, the actual Bureau of Labor Statistics Report for 12 months ending October, 2009 was offered into the record as AG Cross Exhibit 16, and it shows the entirety of the report. Mr. Kerckhove's selective reporting of some measures, while excluding others, is not reliable or convincing.

The Commission understands the AG's concern; ~~however,~~ the record, when viewed in its entirety, supports the elimination of IAWC's proposed inflation adjustment of 1.7%. The Commission adopts ~~concludes that~~ the AG's proposal to remove the adjustment. ~~is not supported by the record and it is not adopted.~~

EXCEPTION VII: Recovery of Prior Rate Case Expense Violates The Rules Against Single Issue and Retroactive Ratemaking and Should Not Be Allowed.

IAWC's last rate case was decided less than two years ago. In that case the Commission allowed the Company to recover its full rate case expense, with the cost of the depreciation and the municipal rate studies amortized over five years and the remainder of the expense amortized over three years. AG/JM Ex. 1.0 at 34. The Commission did not authorize IAWC to defer the unamortized portion of the rate case expense for future recovery if it filed a rate case before the end of the amortization period. Yet in this case, the Proposed Order would allow IAWC to charge ratepayers for the test year rate case plus the unamortized portion of the last case's expense, pancaking one year's expense onto the prior year's expense and violating the rules against single issue and retroactive ratemaking. The Commission allowed IAWC to recover a representative rate case expense and did not discuss the amortization period requested by the Company.   IAWC filed its next rate case before the full amortization period expired, but that does not justify singling out this expense to allow recovery for past expenses in the future. Instead, a representative rate case expense should be set in this docket, without regard to whether IAWC filed a new rate case before or after the amortization period expired.

The Proposed Order lays out the explanation of the rules against single issue and retroactive ratemaking and that discussion will not be repeated here. See also AG Initial Brief at 34-39.

The Proposed Order apparently accepts IAWC's arguments that the Commission "routinely" amortizes rate case expense and allows recovery of the unrecovered balance. Proposed Order at 69. However, the Proposed Order does not address the substantive problems presented by the rules against single issue and retroactive ratemaking. Further, Commission decisions are not *res judicata*, nor is the Commission bound to follow prior rulings. In this instance, the Commission should conclude that the amortization of an ordinary but occasional expense creates a representative cost and not a regulatory asset. That representative cost level is simply replaced by another test year, representative expense is established, irrespective of the test year used to set rates.

EXCEPTION VII: Proposed Language to Remove Recovery of Prior Rate Case Expense Unamortized Balances

The Commission's Conclusion at page 69 should be modified as follows:

3. Conclusion

As noted above, most rate case expense authorized in Docket No. 07-0507 was subject to a three-year amortization period and for that reason has not yet been fully recovered. The AG also takes issue with IAWC's request to recover the unamortized balance from the previous case.

Having reviewed the arguments, the Commission finds that the AG's proposal should ~~not~~ be adopted. Because rate cases do not occur every year, the Commission routinely orders that approved rate case expense be amortized over a multiple-year period; a ratable portion is included in test year expense, as it was in Docket No. 07 0507, and is recovered through rates. The rate case expense is amortized because rate cases are not filed every year, and amortization over a reasonable period of time creates a representative cost level to include in the test year. If the balance will not be fully amortized by the time new rates are approved in the next rate case, the prior cost level is replaced by a new, representative cost level based on the new test year.

Although the Commission has allowed the unamortized amount to be recovered through rates approved in the new docket, we are not bound by that prior finding, which we believe is inconsistent with the test year rule, with the rule against single issue ratemaking, and the rule against retroactive ratemaking. We would not expect IAWC to refund or credit rate case expense if rates were collected for longer than the amortization period, and do not believe that it is appropriate to increase consumers' responsibility for this one cost because IAWC sought a rate increase sooner than it anticipated in its last rate case. ~~Thus, IAWC's proposal is in accord with prior Commission orders.~~

~~Further, although the AG has argued that allowing the recovery of the unamortized balance from Docket No. 07-0507 would be retroactive ratemaking, the opposite argument could just as easily be made. What the AG appears to proposing -- using the instant rate docket to decrease to zero the unamortized balance of rate case expense approved in the prior rate case -- is essentially the flipside of the IAWC adjustment rejected in the subsection of this Order immediately above; there IAWC was trying to use the instant case to change, i.e. increase, the amount of rate case expense approved in Docket No. 07-0507. Here, the apparent effect of the AG's proposal, by denying recovery of the remaining portion of the amount authorized in Docket No. 07 0507, would be to use the current docket to retroactively change, i.e. decrease, the revenue requirement approved in the prior docket.~~

~~The Commission also notes that the fact the unamortized balance of rate case expense is not included in rate base actually helps ratepayers, as no return on the balance is recovered from ratepayers.~~

~~Regarding the amortization period for the unamortized, i.e., unrecovered balance of rate case expense approved in Docket No. 07-0507, the Commission finds that this amount, on a going-forward basis, should be rolled into the same three-year amortization period as is approved below for most current rate case expenses~~.

EXCEPTION VIII: The Current Rate Case Expense, Which is 58% Higher Than The Last Rate Case Expense, Is Excessive And Should Be Reduced For Ratemaking Purposes.

The Proposed Order would have the Commission accept a $2.34 million request case expense, which is 58% higher than IAWC's last rate case expense, barely two years ago. The Proposed Order effectively ignores the specific objections of the AG and the municipalities and the Commission's statutory obligation to:

> "specifically assess the justness and reasonableness of any amount expended by a public utility to compensate attorneys or technical experts to prepare and litigate a general rate case filing. The issue shall be expressly addresses in the Commission's final order."

220 ILCS 5/9-229 (effective July 1, 2009). The Proposed Order relies on the Staff's failure to object to the Company's request while not assessing either the basis for the Staff's position or the reasonableness of the fees claimed.

In reviewing the costs claimed as current rate case expense, there are two areas of cost that show an unreasonable increase. Specifically, IAWC asked to charge consumers $422,900 for a 22 page, 8 schedule "Service Company Study" which basically multiplied the number of Service Company hours by hourly rates obtained from hourly rate surveys.[13] By contrast, IAWC is asking $249,540 for *both* the demand and the cost of service studies, which together produced hundreds of pages of cost information, analysis and proposed rates as well as testimony. IAWC Ex. 13.00, 13.00R1, 13.00 R2, 13.00 SR; a Report on Capacity Factors by Customer Class, IAWC Ex. 13.01 (April, 2009), a revised Report, IAWC Ex. 13.01 R1 (October 2009); IAWC Ex. 9.00, 9.01 (cost of service studies) through 9.10. The Service Company Study cost is clearly unreasonable both on its own merits and by comparison to other studies produced for this docket.

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[13] Mr. Uffelman testified that he assumed that a non-affiliated provider would bill the same number of hours that AWWSC bills IAWC for the same work, Tr. 375-376, and that the distribution of work among different levels of experience and education would be the same for affiliated and non-affiliated providers. Tr. 378. Effectively, the only variable in the study was the market hourly rate, which was compared to AWWSC's "fully loaded" rates.

The legal expense increased by 43% over the 2007 legal expense,[14] equaling $930,000. IAWC argues that it actually spent that much in its last rate case, so it should be allowed that amount in this case too. This argument creates a dangerous precedent and removes the incentive for a utility to control costs if the budgeted cost is ignored on a going forward basis. Further, such a large increase in cost is unfair to consumers who already are paying far more for their water and sewer service than surrounding communities pay. IAWC should be finding ways to cut costs – not running up huge legal expenses at rates up to $525 per hour. It is unreasonable for a cost to increase 58% over a two year period, and a specific assessment of the current rate case expense shows that both the legal expense and the cost of the Service Company Study need to be cut.

While allowing this 58% increase in cost, the Proposed Order would have the Commission order the Company to "fully document its efforts to control rate case expenses" and to "provide cost estimates" for studies so the Commission "will have the opportunity to determine if such studies are cost-effective before the costs are actually incurred and passed on to ratepayers." Proposed Order at 78. The Commission should delete both this requirement and the need for it.

The Commission does not need more studies or more documentation of cost control efforts. Instead, the Commission must simply exercise the authority it has to reject costs that are excessive and unreasonable. Rejecting a 58% increase in cost over 2 years will assure that "cost control" methods are put in place because the Company will understand that it will take more than a simple request to impose such a substantial increase on the public. On the other hand, if the Commission allows IAWC to increase this charge by 58%, it is predictable that IAWC will produce expensive and extensive

[14] The legal expense in 2007 was $615,000. See AG/JM Ex. 1.0 at 38-39.

data, studies, and reports justifying its continually increasing charges. Meanwhile, the Staff and intervenors will be drowned in details, studies and reports while consumers see their bills skyrocket.

The Commission should specifically assess the legal expenses and technical expert expenses claimed by IAWC, modify the amounts requested, and amend the Proposed Order to reject the 58% increase in rate case expense requested by IAWC.

EXCEPTION VIII: Proposed Language to Disallow Unreasonable and Unjustified Rate Case Expenses

The paragraph labeled 5. Commission Conclusion on page 77 should be amended as follows:

5. Commission Conclusion

<u>Between IAWC's last rate case and this rate case, the General Assembly amended the Public Utilities Act to require the Commission to "specifically assess the justness and reasonableness of any amount expended by a public utility to compensate attorneys or technical experts to prepare and litigate a general rate case filing. The issue shall be expressly addresses in the Commission's final order." 220 ILCS 5/9-229 (effective July 1, 2009). In response to this legislative mandate, we must look carefully and specifically at the costs IAWC claims for legal assistance and technical experts.</u>

The Company is requesting a total rate case expense of $2,339,496. The AG and Municipalities takes issue with IAWC's proposal<u>, pointing out that it represents a 58% increase over the same expense in IAWC's 2007 rate case and that legal expenses are 43% higher. They also assert that the $422,900 price tag for the Service Company Study is unreasonable and should be rejected or modified.</u> Staff, on the other hand, reviewed the Company's rate case expenditures, and found them to be reasonable. <u>Pursuant to Section 9-229, the Commission must specifically address these expenditures.</u>

~~Among other things, the AG complains, at the outset, that the $2.34 million rate case expense requested by IAWC is 58% higher than the $1.48 million 2007 rate case expense approved in Docket No. 07-0507,~~

IAWC responds that its actual rate case expense for Docket No. 07-0507 was $2,347,164, which is $7,668 more than the projected cost of the current case. (IAWC Schedule C-10.1) IAWC calculates the projected costs of legal fees and expenses, revenue requirement and CPA review to be lower than amounts actually incurred in the prior case by 7%, 51% and 47%, respectively. IAWC and the Staff witness did not address the substantial *increase* in the cost actually paid by consumers.

The Commission rejects the argument that because IAWC's actual expense was higher than the amount it requested in its last rate case, a 58% increase is warranted or justified in this case. IAWC has control over its rate case expense, and if it chooses to exceed its budgeted amount, shareholders (who benefit from rate increases) can absorb the difference.

The AG witness testified that legal expenses are excessive, and the amount allowed in this case should be no more than 10% higher than the $650,000 approved in the last rate proceeding. IAWC contends that the legal services are necessary, and reflect cost-control measures utilized by IAWC. We find that a 43% increase in legal expenses is not reasonable. If IAWC adopted cost-control measures, it should not have allowed costs to increase to such an extent. We agree with the AG that the increase in legal expenses has not been explained and that consumers should not have to pay this steep increase in less than two years.

The AG asserts that the cost of the service company study is "outrageous" and should be disallowed. Section 9-229 requires that we specifically assess the costs of technical experts. IAWC claims $422,900 for this study, which consisted to 22 pages of text and eight schedules. It was based on wage and other surveys, and relied on IAWC and the Service Company to identify the services, number of hours, professional and technical cost and expertise required to perform Service Company functions. According to the AG and several municipalities, the study assumed that a non-affiliated provider would bill the same number of hours that AWWSC bills IAWC for the same work, and that the distribution of work among different levels of experience and education would be the same for affiliated and non-affiliated providers. Effectively, the only variable in the study was the market hourly rate, which was compared to AWWSC's "fully loaded" rates. It does not appear that this study required a particularly high level of expertise or analysis.

We also compare the cost of this study with other studies presented by IAWC. IAWC asks for $249,540 for the demand study and the cost of service study together. IAWC asked for $37,000 for the study comparing municipal utilities with IAWC in its last rate case, although requested recovery of $224,000 for the 2007 study in this docket. By contrast, IAWC seeks $422,900 for a study requiring less expertise. We find that IAWC has not met its burden of proof to justify the cost of the Service Company Study and disallow that expense. ~~On this issue, the Commission has found, elsewhere in this Order, that the service company cost studies performed by IAWC represent a reasonable effort to~~

~~comply with the directive of the Commission in Docket No. 07-0507. This cost should not be eliminated from allowable rate case expense.~~

~~Regarding other rate case expense, including legal expenses, the Commission agrees with the conclusion of Staff, which entered into evidence numerous data request responses it reviewed in its assessment of fees to attorneys and technical experts, that the Company's rate case expenses are just and reasonable within the meaning of Section 9-229 of the Act, 220 ILCS 5/9-229. The record shows that the services were reasonably necessary in the preparation and presentation of the case, and that the Company undertook reasonable measures to control the costs. Thus, while lowering rate case expense is a desirable goal, the record supports the inclusion, rather than disallowance, of the expense proposed by IAWC.~~

~~For future cases, the Commission directs IAWC to fully document its efforts to control rate case expense. Furthermore, in this order, in situations where future cost studies appear to offer potential benefits, the Commission is ordering IAWC to provide cost estimates for such studies so that the Commission will have the opportunity to determine if such studies are cost-effective before the costs are actually incurred and passed on to ratepayers.~~

With regard to the amortization period for rate case expense, the Commission finds that a five-year period should be used for the costs of the cost of service study, demand study, and SCCS. For other rate case expenses, IAWC's two-year proposal warrants consideration. However, upon consideration of the record, including intervals between prior rate cases, the Commission believes that a three-year period, proposed by the AG, should be used. As noted above, the Company will not earn a return, through rate base, on the unamortized balance, which is of benefit to ratepayers.

EXCEPTION IX: The Proposed Order Mistakenly Reduced Long Term Debt Rather Than Common Equity In Setting A Reasonable Capital Structure For IAWC.

The Proposed Order adopted a capital structure for IAWC consisting of 2.83% short term debt, 49.84% long term debt, and 47.33% common equity. Proposed Order at 84. This modifies the Company's requested capital structure by including a representative proportion of short term debt. Because short term debt is the least costly type of debt, it is reasonable and economical to include a short term debt component in the capital structure, particularly in this case where it was demonstrated that IAWC uses short term debt to, inter alia, fund operations or while it arranges other financing.

IAWC had requested a capital structure with virtually no short term debt (0.15%) and 48.63% common equity. Proposed Order at 84. Its long term debt is based on actual long term debt obligations. IAWC Ex. 4.00. As a result, the proportion of common equity – not the proportion of long term debt -- should have been reduced when recognizing a reasonable portion of short term debt in the capital structure. In addition, common equity is the most expensive portion of a utility's capital structure, and reducing the portion of common equity will produce a more reasonable capital cost for consumers.

The Proposed Order should be amended as follows.

EXCEPTION IX: Proposed Language to Increase The Amount of Long Term Debt and Reduce Common Equity In IAWC's Capital Structure.

The Commission Conclusion on page 84 should be modified as shown below.

4. Commission Conclusion

IAWC proposes a forecasted 2010 capital structure consisting of 51.22% long-term debt, 0.15% short-term debt, and 48.63% common equity. IAWC's proposal is also supported by Staff. IIWC proposes a capital structure consisting of 52.24% long-term debt, 2.83% short-term debt, and 44.94% common equity, which was based on IAWC's December 31, 2008 capital structure. AG/JM recommended a capital structure consisting of 51.22% long-term debt, 3.26% short-term debt, and 45.52% common equity.

It is important to remember why a test year is utilized in the ratemaking process. Generally speaking, the test year is utilized so that revenues and expenses are matched relatively well for the period when rates will be in effect. The Commission is concerned that IAWC's forecast capital structure for 2010 may not be not representative of what it has been in the past or what it will be in future periods when rates set in this proceeding are in effect. In other words, the Commission believes that IAWC's forecasted test year capital structure for the capital structure, while arguably reasonable for that year, may not be sufficiently representative of IAWC's typical capital structure. The Commission notes that in

Docket No. 07-0507 the approved capital structure for IAWC was comprised of 52.97% long-term debt, 3.26% short-term debt, and 43.77% common equity.

The Commission finds that IAWC's capital structure should include more short-term debt than that the 0.15% it has proposed. As Intervenors have observed, when short-term debt is the least expensive component of capital, ratepayers will pay a higher return if the percentage of short-term debt is too low, since the overall cost of capital is used to calculate return on rate base. The Commission believes that the proportion recommended by IAWC witness, Mr. Gorman, 2.83% is appropriate for purposes of this proceeding. Increasing the short-term will require that other components be reduced in some manner. The Commission believes it is appropriate to reduce IAWC's ~~long-term debt and~~ common equity percentage <u>by the same amount that short term debt is increased.</u> ~~in proportion to the amounts that IAWC projects for 2010.~~ This produces a capital structure comprised of ~~49.84%~~ <u>51.22%</u> long-term debt, 2.83% short-term debt, and ~~47.33%~~ <u>45.95%</u> common equity, which the Commission finds to be reasonable. <u>This creates a least cost capital structure by preserving the long term debt component, and setting the common equity component between the amount recommended by IIWC and IAWC.</u>

EXCEPTION X: Consistent With Past Commission and Staff Practice, The Proposed Order Should Be Modified To Adopt The Cost Of Short Term Debt Based On The Most Recent Actual Cost.

On page 85 the Proposed Order briefly discusses the cost of short term debt. The Proposed Order recognizes that the Commission Staff ordinarily uses the actual cost of short term debt, and that the Staff "disagreed with IAWC's use of forecasted interest rates to determine the cost of short-term debt as a matter of sound financial principle." Proposed Order at 85. The Staff witness did not insist on the use of the actual short term interest rate because the very small portion of short term debt proposed by the Company (0.15%) rendered the effect of the short term debt cost *de minimus*. However, with the adoption of a more reasonable short term debt amount, the cost of short term debt is more significant.

IAWC witness Rungren testified that the actual cost of short term debt for November, 2009 was 0.3437%. Tr. at 320 (Dec. 8, 2009). Yet, the Proposed Order adopts a forecasted short term debt cost despite the Commission's policy to use the actual cost. The Proposed Order should be modified to adopt the actual short term debt for the 2.83% short term debt component.

EXCEPTION X: Proposed Language To Adopt the Actual Cost of Short Term Debt

On page 86, the following changes should be made to the Commission Conclusion.

3. Commission Conclusion

With respect to the cost of short-term debt, IAWC proposes to use its average projected cost of short-term debt for the 2010 test-year, 1.97%. The AG recommends a cost of short-term debt at the "current rate," 0.3437%, for purposes of setting rates. IIWC proposes using a short-term debt cost of 1.0%. Staff's witness estimated the cost of short-term debt to be 1.0% but because the IAWC-proposed proportion of short-term debt is so small, Staff did not object to using IAWC's propose cost of short-term debt.

<u>It has been the Commission's practice to apply the most recent, actual short term debt cost when determining a utility's overall cost of capital. The record included IAWC's November, 2009 cost of short term debt to be 0.3437%,</u> The cost of short-term debt calculated by Staff witness Kight-Garlisch, 0.9961%, and IIWC witness Gorman, 1.0%, are essentially the same<u>, but these are forecasted numbers, and will not be used because the actual cost is available in the record.</u> ~~and, in the Commission's view, the most reasonable cost rate proposed by any witness. The method used by Staff witness Kight-Garlisch is consistent with the method typically adopted by the Commission. Even though Staff does not object to the IAWC's proposed cost of short-term debt, the Commission concludes that for purposes of setting rates in this proceeding, a cost rate of 1.0% is reasonable and should be used.~~

The cost of long-term debt, while subject to several proposed revisions, does not appear to be a point of disagreement. Staff was the last party to make a recommendation regarding the cost of long-term debt, a proposed cost rate of 6.24%. IAWC accepted that proposed cost rate and neither the AG nor IIWC appear to recommend a rate different than that proposal. For purposes of establishing rates in this proceeding, the Commission finds Staff's proposed cost rate for long-term debt, 6.24%, to be reasonable and it is hereby adopted.

EXCEPTION XI: Adopt The Cost Of Common Equity Proposed By The Citizens Utility Board.

Common equity is the most expensive component of a utility's capital structure, and it is critical that the Commission recognize investors' reduced expectations during the current recession and market correction. The People support the cost of common equity proposed by Christopher Thomas of the Citizens Utility Board.

EXCEPTION XII: Unwarranted and Excessive Increases To The Customer Charge Will Cause Consumer Dissatisfaction and Undermine Incentives To Conserve Water.

The Proposed Order makes a fundamental error in its assessment of the customer charge. It equates customer cost with the customer charge, effectively assuming that all costs that are customer related should be recovered in a fixed customer charge. Proposed Order at 166. This assumption will unreasonably drive up customer charges, limiting rate design options and distorting the incentives that could be developed to encourage conservation. Rather, the category of customer costs associated with the customer charge are those costs necessary to connect a customer to the system, such as the service line, the meter and billing costs. Proposed Order at 159 (The AG's Position). If all customer related costs are expected to be recovered in the customer charge, bills will become so dominated by fixed charges that consumers will have little cause to conserve – the effect of conservation on their bills will be negligible. The rate design in the Proposed Order moves too far in that direction.

The Commission should not assume that higher fixed, customer charges are always desirable. IAWC's customers currently pay a fixed public fire charge (or a higher fixed private fire charge), and sewer collection customers pay $17.52 as their sewer customer charge, with a very low usage charge of only 1.355 cents. Sewer collection and treatment customers are being asked to pay $37.02 in fixed charges. Staff Ex. 12.0, Sch. 12.1R Chicago WW; Proposed Order at 189. Purchased water customers may pay an additional fixed charge. For example, in Mount Prospect the fixed charge is now 11.97. AG Ex. 7.0. The customer charge is only one of the fixed charges on the bill, and as fixed charges accumulate the impact of usage becomes smaller and smaller.

Although water conservation is a laudable goal, the cost for basic water usage should not be so high that consumers are discouraged from using water for basic needs. High fixed charges relative to low usage charges can have two conflicting, but both negative, effects. First, consumers can try to reduce their bills by using less and less water, incurring costs for low-flow appliances or inconveniencing themselves by severely limiting ordinary water use (e.g. going to the gym or other public facility that pays commercial rates to shower). This approach will be fruitless because the fixed charges will remain high and consumers will be frustrated because nothing they do will bring down their bills. See e.g., Mt. Prospect Public Forum at 22, (Oct. 8, 2009); Wheaton Public Forum at 29, 36, 61, 64 (Nov. 4, 2009).

The second effect is that consumers realize that their bill is dominated by fixed charges, in some cases exceeding $60 per month. The effect of increased usage is relatively minor, so increasing usage by 2 ccf (1,496 gallons) per month adds less than $10 to a bill (e.g. $3.703/ccf as proposed by Staff for Zone 1, Staff Ex. 14.0, Sch. 14.1RC; $2.10/ccf as proposed by Staff for Pekin and $3.593/ccf as proposed by Staff for Chicago District-Bolingbrook, Staff Ex. 12.0, Sch. 12.3). If the Commission wants to encourage conservation while providing a reasonable rate for the threshold level of water necessary for health and public welfare, it should reduce the fixed charge (or at least not increase it excessively) and establish rates to collect more revenue through usage charges. If conservation is a Commission goal, it must moderate the movement toward fixed charges that the Proposed Order assumes is the Commission's goal.

EXCEPTION XII: Proposed Language to Limit Increases In Customer Charges

The Proposed Order includes an extensive discussion of the parties' positions. No changes are proposed to the discussion of the AG's Position. However, the discussion of Homer Glen's Position should be changed to be the "Municipalities Position" because many of the issues are raised in connection with the City of Champaign, which was represented by counsel. The City of Champaign will recommend changes to the Proposed Order to correctly identify the party to whom the arguments should be attributed, and the People support those changes.

The Commission Conclusion, starting on page 164, should be amended as follows:

5. Commission Conclusion

~~Putting aside, for the moment, IAWC's minimum system charge proposal,~~ IAWC proposes movement toward a uniform customer charge as follows: a $~~16.00~~ $17.75 per month charge for Zone 1, including Sterling, and Pekin, a $~~14.00~~ 15.75 per month charge for Champaign, a $~~13.50~~ 15.75 per month charge for Chicago Metro - Water, a $~~10.50~~ 12.25 per month charge for Lincoln and a $~~10.40~~ 12.15 per month charge for South Beloit. These amounts include a $1.75, which the Company includes as part of its "minimum system charge" proposal.

As discussed above, IAWC ~~also~~ performed what it calls a minimum system analysis and ~~proposes that a~~ the above charges include a $1.75 minimum system charge. ~~be added to the customer charge.~~ IAWC's analysis purportedly shows the cost of connecting a customer to its system with the minimum size main is $4.67 per customer. IAWC proposes that the customer charge be increased by $1.75 per month to begin recovery of the minimum system cost through a fixed charge. This proposal is opposed by both Staff and the AG, and is addressed below.

The AG asserts that cost of service supports maximum customer charges of $13.47 for Zone 1, $12.75 for Chicago Metro, $11.78 for Lincoln and, $13.37 for Pekin. For Zone 1, the AG recommends no change in the existing $13.39 monthly customer charge. The AG asserts that IAWC improperly included costs associated with overheads and general plant in its customer costs. IAWC contends that such costs are properly reflected in the customer cost.

Staff recommends customer charges as follows: $14.50 for Zone 1, including Sterling and Champaign; $14.50 for Pekin; $13.50 for Chicago Metro Water; and $10.50 for South Beloit and Lincoln. Because the Commission has supported the recovery of fixed costs in the customer charge and has also approved recovery of fixed costs in the customer charge of 80% for certain gas utilities in Illinois, Staff recommends that 80% of the Company's statewide customer costs of $18.14 per month, or $14.50, be the maximum customer charge for 5/8" meter customers in each rate area of IAWC.

Homer Glen objects to IAWC's proposal to "shift costs" from the usage charge to the customer charge, noting that it would cause customers who use lower volumes of water to pay proportionately higher costs.

As noted above, IAWC proposes to assess a minimum system charge. As an initial matter, the Commission observes that IAWC described its minimum system charge proposal as a rate design proposal and included it in that portion of its briefs. Staff, on the other hand, addressed the proposal as if it were a cost of service issue. Despite IAWC's suggestions, the Commission agrees with Staff that the minimum system issue is essentially a cost of service issue. (See, e.g., Central Illinois Light Company d/b/a AmerenCILCO, et al., Docket No. 07-0585 et al. (Cons.), September 24, 2008, Order at 273-78 and 281-82) In the Commission's view, IAWC's characterization of the minimum system as a rate design issue does not somehow change the underlying nature of the issue or distinguish it from prior cases.

Staff correctly points out that minimum system approaches to cost of service have been presented to the Commission numerous times and have consistently been rejected. In response to the Commission's view that generally, fixed costs should be recovered through fixed charges, IAWC suggests that the minimum system approach represents a rate design proposal to achieve that goal. The Commission, however, is not prepared to fundamentally revise its approach to cost of service by framing the minimum system proposal as a rate design issue.

Thus, while the Commission continues to encourage IAWC to identify fixed costs and to propose reasonable methods for recovering fixed costs ~~through fixed charges rather than through variable usage charges~~, the Commission does not believe the minimum distribution system as proposed in this proceeding represents an acceptable method for doing so.

~~Therefore, although the Commission remains open to the possibility that the minimum distribution approach may have merit, it will take a more convincing record than is presented in this proceeding.~~ The Commission finds that the record does not support IAWC's minimum system approach or its proposed minimum system charge, and the proposal is therefore rejected.

With regard to the types of costs properly collected through the customer charge, the AG suggests that costs not directly related to connecting a customer to the system, reading the customer's meter and sending the customer a bill must be excluded from the monthly customer charge. As an initial matter, we note that a cost of service study allocates costs as customer, capacity, or other costs. We agree with the AG that the customer charge should be limited to recovering the subset of customer related costs related to connecting a customer to the system, i.e. the service line, the meter, and customer billing. These costs are directly related to the provision of service to each customer, as opposed to the more general fixed costs, such as administration and general (e.g. the President's desk). AG witness Rubin identified numerous customer cost accounts that he believes are associated with connecting a customer and providing the plant necessary to serve each customer (service line, meter, billing). This creates a reasonable distinction between customer related costs that should be included in the fixed charge and other customer related, fixed costs that are more generally related to the provision of service. ~~it appears to the Commission that the AG is making a cost of service argument rather than a rate design argument. Nevertheless, because this is a discrete argument and all parties addressed it under the rate design section of their briefs, the Commission will address it here. The Commission finds no reason to assume that all indirect or overhead costs are variable costs, rather than fixed costs, in nature. Similarly, the Commission believes there is no reason to assume that all customer costs are direct costs rather than a combination of direct and indirect costs~~.

From a rate design perspective, all other things being equal, the Commission believes it is preferable to recover costs related to serving a single customer, i.e., the service line, the meter, and billing in the customer charge. Because utilities like IAWC have a high proportion of fixed costs versus variable costs, if fixed costs were recovered through fixed charges, customers would see little variation in their bills based on usage. This type of rate design discourages conservation and consumers find it frustrating to lack control over the size of their bill. ~~for fixed costs to be recovered through fixed charges, and for variable costs to be recovered through variable charges, such as usage charges. As IAWC and~~

~~Staff note, this view has been reflected in recent rate orders including Docket No. 07-0507~~.

Based on the considerations above, the Commission finds the types of costs included in ~~IAWC's calculations~~ AG witness Rubin’s calculation of the customer charge appear to be a more accurate representation of ~~fixed~~ costs to be properly recovered through the customer charge, and the AG's proposed calculations of the fixed customer costs will ~~not~~ be adopted.

With respect to the amount of the customer charge, Staff, as noted above, recommends that 80% of IAWC's statewide customer costs of $18.14 per month, or $14.50, be the maximum customer charge for 5/8” meter customers in each rate area of IAWC. The Commission appreciates that Staff has reviewed and considered the orders in recent rate cases. It appears, however, that Staff may have placed too much significance on the 80% figure appearing therein. In those cases, the Commission was dealing with natural gas utilities that expressed specific concerns about sales and revenue decoupling. Additionally, the 80% fixed cost recovery was adopted as an alternative to the specific revenue decoupling mechanisms proposed by the natural gas utilities.

~~While the Commission maintains that the 80% fixed cost recovery previously adopted was reasonable, the Commission did not intend for it to somehow become the overriding determinant of customer charges.~~ The Commission believes that in determining appropriate customer charges, the calculated cost of service, the dollar amount of existing customer charges, the dollar amount of proposed customer charges, and the proposed percentage increases are relevant and should not be ignored.

To assist in determining at what level the 5/8 inch meter customer charges should be set, the Commission has developed the table below, which excludes IAWC's minimum system charge rejected above.

Monthly 5/8 inch Meter Customer Charges for Water Service

District	Current Charge	~~IAWC~~ AG Calculated Cost	IAWC Base Charge	Staff Proposed	AG Proposed
~~South Beloit~~		~~19.29~~			
Zone 1	6.92	13.47	10.40	10.50	13.39
~~Champaign~~	~~11.23~~	~~14.11~~	~~14.00~~	~~14.50~~	~~13.39~~
~~Sterling~~	~~9.09~~	~~19.29~~	~~16.00~~	~~14.50~~	~~13.39~~
~~Streator~~	~~13.39~~	~~19.29~~	~~16.00~~	~~14.50~~	~~13.39~~
~~Pontiac~~	~~13.39~~	~~19.29~~	~~16.00~~	~~14.50~~	~~13.39~~
~~Southern~~	~~13.39~~	~~19.29~~	~~16.00~~	~~14.50~~	~~13.39~~

Pekin	12.74	~~20.05~~ 13.37	16.00	14.50	13.39
~~Peoria~~	~~13.39~~	~~19.29~~	~~16.00~~	~~14.50~~	~~13.39~~
Lincoln	7.91	~~21.61~~ 11.78	10.50	10.50	11.78
Chicago Metro	9.75	~~17.62~~ 12.75	13.50	13.50	12.75

In determining reasonable monthly customer charges, there are numerous considerations, some of which are not directly aligned. Among others, those considerations include uniformity of charges, cost-based rates, customer incentives, including both public health and conservation incentives, as well as dollar and percentage impacts on customer bills. All things considered, the Commission believes that a combination of the customer charges proposed by the AG ~~IAWC, excluding the minimum system charge,~~ and by Staff, will result in the most reasonable 5/8 inch meter customer charges. The customer charges recommended by AG witness Rubin most closely match the appropriate costs that should be the basis of a customer charge and includes the costs directly associated with serving a single customer while avoiding the trap of putting excessive fixed costs into the customer charge. We adopt the Staff customer charge recommendations in the South Beloit and Lincoln Districts, which recognize the currently lower customer charges in those districts and minimize rate shock resulting from the steep increases requested in this docket.The table below shows the customer charges the Commission herein approves.

Monthly 5/8 inch Meter Customer Charges

District	Current Charge	~~Calculated Cost~~	Approved Customer Charge	Percentage Increase
South Beloit	6.92	~~19.29~~	10.50	51.7%
Champaign	11.23	~~14.11~~	~~14.50~~ 13.39	29.1%
Sterling	9.09	~~19.29~~	~~14.50~~ 13.39	59.5%
Streator	13.39	~~19.29~~	~~16.00~~ 13.39	19.5%
Pontiac	13.39	~~19.29~~	~~16.00~~ 13.39	19.5%
Southern	13.39	~~19.29~~	~~16.00~~ 13.39	19.5%
Pekin	12.74	~~20.05~~	~~16.00~~ 13.39	25.6%
Peoria	13.39	~~19.29~~	~~16.00~~ 13.39	19.5%
Lincoln	7.91	~~21.61~~	10.50	32.7%

Chicago Metro	9.75	~~17.62~~	~~13.50~~ 12.75	38.5%

EXCEPTION XIII: The Commission Should Make IAWC's Consistent By Treating All Large Users The Same, Regardless Of Whether They Are Classified As Residential Or Commercial.

The Proposed Order order recognizes the interest in moving to uniformity among IAWC rate areas, but adopts a usage rate structure that is inexplicably inconsistent. The Proposed Order would allow IAWC to eliminate the declining block rate outside of the Chicago Metro area while requiring that IAWC allow the large residential users outside of Chicago Metro to be classified as nonresidential so they can retain the declining block structure that is currently available to them as large users. Proposed Order at 173. This conclusion highlights the problem identified by AG witness Rubin and can be easily resolved by treating customers based on volumes used rather than by residential, commercial, or industrial classifications.

IAWC currently has a single block rate for residential customers in Chicago Metro, and it proposes to extend that rate design throughout its service area. Proposed Order at 168. It is undisputed that more than 99% of IAWC's residential class currently fall within the first billing block (id.), so the elimination of the declining block will not have a major impact on their bill, but at the same time will discourage occasional, excessive use. However, there is one major exception to this expectation.

Currently large residential customers in all areas except Chicago Metro are on a declining block rate similar to the rate structure applicable to commercial users. The classification of the customer as residential or commercial (e.g. an apartment building, a nursing home, a dormitory) is irrelevant outside Chicago Metro because the rate is the same for customers using larger quantities of water. This is consistent with cost of service principles where the larger users impose lower costs on the system.

To recognize the consistent usage needs and patterns of mult-unit buildings and other large users of water, AG witness Rubin recommended that the declining block structure outside Chicago Metro be imported into Chicago Metro. Because the overwhelming majority of residential customers are not large enough to take service from the second, declining block, it will effectively serve only the larger multi-unity buildings. This is an appropriate rate design for both Chicago Metro and for areas outside Chicago Metro. The Proposed Order suggestion that a single residential rate design apply to all IAWC, but that residential, multi-unit buildings outside Chicago Metro have the option of going on a commercial rate with a declining block defeats the very uniformity sought by the change. To preserve uniformity and to provide an appropriate rate for very large residential buildings, the same rules should apply in Chicago Metro as apply in the rest of the state.

The Proposed Order concludes that "declining block structure fail to provide proper price signals to encourage conservation." Proposed Order at 173. This conclusion is correct as far as it relates to ordinary residential consumers. However, large, multi-unit residential buildings often classify common area usage as commercial, obtaining a commercial rate for clothes washing and outdoor watering. Further, it is unreasonable to expect a meter serving 20 or more living units to use the same volume of water as a meter serving a single family, or even up to four families. A properly designed declining block, which begins only at a level suitably high for multi-unit service, will not affect or undermine the conservation effect of a single block rate.

The People do not oppose a uniform residential block structure, provided residential multi-unit buildings in Chicago Metro and in IAWC's other service territories have the same option to take service under the declining block either as residential or as commercial customers. The Proposed Order should be modified either to eliminate the declining residential block or to make a declining block available to large residential buildings that use water a higher, commercial levels.

EXCEPTION XIII: Proposed Language To Treat Chicago Metro Multi-unit Residential Buildings The Same As Other IAWC Multi-unit Residential Buildings.

On page 172, the Commission Conclusion should be changed as follows:

5. Commission Conclusion

With regard to unit rates based on customer usage, IAWC proposes to eliminate the declining block structure for residential customers outside of Chicago Metro, which already has a single block residential rate structure, and replace it with a single block structure. Staff supports this proposed rate structure.

The AG believes <u>that the declining block structure outside Chicago Metro should be retained for large residential buildings which exhibit the same economies of scale associated with larger commercial customers. The AG asserts that</u> a properly sized declining block usage rate structure will recognize these economies of scale while retaining the conservation message for <u>the overwhelming number of</u> smaller residential customers who do not use enough water in a given month to trigger the declining block. Rather than eliminating the declining block structure outside of Chicago Metro, the AG would rather see the declining block structure adopted in the Chicago Metro rate area<u> so that larger, multi-unit apartment buildings are treated the same as such customers outside Chicago Metro</u>. Homer Glen expresses concerns similar to those raised by the AG.

~~It appears that the AG's primary concern is~~ The AG's primary concerns are that there be rate uniformity between Chicago Metro and the rest of the state; that the residential rate appropriately reflects the economies of scale associated with water usage in large, multi-unit buildings; and that multifamily residential buildings, such as apartment buildings, outside of Chicago Metro, potentially face significant increases if the declining block structure is eliminated. IAWC responds that multifamily dwellings outside of Chicago Metro are typically not classified as residential and will continue to see a declining block rate structure. (IAWC Initial Brief at 145)

Although the Commission believes declining block structures fail to provide proper price signals to encourage conservation, the issue here is not whether the vast majority of residential customers should benefit from a declining block rate. Currently, more than 99% of residential customers never use enough water to trigger the declining block, so they do not have an incentive to use more water. The block structure at issue will not affect these customers.

The real issue is whether large, multi-unit residential buildings should be treated the same as single family or other small residential users. In all districts outside Chicago Metro, declining block rates apply regardless of classification, triggered solely by usage, and the record demonstrates that multi-unit buildings are the only residential buildings that fall within this usage range. It is not appropriate to treat multi-unit residential buildings the same as single family residential units because their usage patterns are different. The Commission ~~does not~~ believes that a declining block structure for multi-family residential customers in the Chicago Metro area is ~~would be~~ in the public interest and the AG's proposal to do so is ~~not~~ adopted. ~~It appears, however, that~~ The AG has ~~may have~~ raised a valid concern for some multifamily dwellings outside of Chicago Metro, and we believe that the same concerns apply to similarly situated customers in Chicago Metro. ~~IAWC's response suggests that there may be some multifamily dwellings outside of Chicago Metro that are, in fact, classified as residential.~~ Thus, IAWC's proposal to eliminate the declining block rate structure for the residential class is approved; however, IAWC is hereby required to allow any multifamily dwelling outside Chicago Metro or within Chicago Metro ~~that is currently classified as residential~~ to be reclassified as nonresidential, at the customer's request to assure uniformity across the state, and provide appropriate recognition of the different usage patterns associated with single family and multi-family residences.

EXCEPTION XIV: A Multi-unit Residential Building Classification Study Is Not Necessary If The Commission Simply Treats Chicago Metro and The Rest Of Illinois Uniformly.

The Proposed Order recommends acceptance of IAWC's offer to review its multi-family residential customers to determine how they are classified, and consider whether to propose a "uniform classification" in the Company's next rate case. Proposed Order at 184. It is unnecessary for the Commission to address this question if, as proposed above, the Commission adopts, in this docket, a uniform declining block rate for all customers, regardless of classification as residential, commercial, or otherwise.

EXCEPTION XIV: Proposed Language regarding Multi-unit Buildings

J. Multi-unit Residential Building Classification

The AG also recommends that the Company should be required to file with its next case sufficient data to establish apartment and condominium customers as a separate customer class. (AG Ex. 2.0 at 21) The AG points to the size of meters and rates of consumption at certain structures to suggest that customers outside Chicago Metro are likely master-metered multifamily residences.

IAWC asserts that these indicia (meter size and volume of consumption) do not lead to the conclusion that the identified structures are indeed master metered multi-family residences. IAWC has reviewed its records and confirmed that only two multi-family customers outside of Chicago Metro are classified as residential. To address the AG's concern, however, IAWC has agreed to engage in a review of its multi-family residential customers to determine their customer classification and propose, if appropriate, a uniform classification of these customers based on the review's findings. IAWC says such revisions, if any, would be included in the Company's next rate case. (IAWC Initial Brief at 146-147)

The Commission finds that the review proposed by IAWC, in response to the AG witness' recommendation, is <u>unnecessary in light of our conclusion that multi-unit residential buildings in Chicago Metro and in the rest of the state are treated uniformly, and have access to a declining block rate if their usage falls within the declining rate set for commercial users. IAWC is of course free to offer a review of its multi-unit residential users in its next rate case, but it is not required or ordered to do so unless it proposes to change its rate so that these customers are treated differently from other commercial customers or are treated differently from one district to the next. </u>~~reasonable and shall be undertaken.~~

EXCEPTION XV: The Commission Should Order An Independent Study of IAWC's Wastewater Treatment Costs and Service To Determine If It Is Capable Of Providing Service At a Reasonable Cost.

As described in the Proposed Order, IAWC is currently recovering only a fraction of its calculated wastewater treatment costs in rates. Proposed Order at 185 (according to IAWC, 39% of cost of service recovered). The rates set in this docket will only move toward collecting the cost of service, while wastewater collection only customers pay the costs associated with that service.

While AG witness Rubin testified that it would cost consumers about $70.00 to pay the cost of wastewater treatment service for 7 ccf (approximately 5,000 gallons), IAWC suggested the price would be $63.50. Proposed Order at 186. Either way, these are very high rates, particularly compared to the significantly lower rates paid by customers of the Metropolitan Sanitary District ($16.06 or $20.64 per month); to IAWC customers who pay municipalities for purchased wastewater treatment service ($17.23, $21.28, and $44.85 per month); and to customers in communities near Homer Glen (Mokena, New Lenox, Joliet, Manhattan and Plainfield).

An additional concern is that in 2007, IAWC reduced wastewater service revenues by 15.58%. Docket 07-0507, Order, App. C (July 30, 2008). IAWC does not seem to know what it costs to provide wastewater treatment service and consumers are faced with significantly fluctuating rates. Further, the Company has not provided an explanation for the large disparity between its costs and rates and those of other systems or for the change in the costs it measured and presented to the Commission from 2007 to 2009.

IAWC has only 9,000 wastewater treatment service customers. This is a small group, and the Commission should take steps to protect them from the high rates indicated by the Company, and to protect the wastewater collection only customers who are being compelled to subsidize the cost of IAWC's wastewater treatment service. IAWC's very high cost of service needs to be investigated to determine what is driving it and why it is so much higher than the costs of other, neighboring communities.

The Public Utilities Act gives the Commission the authority to alter or modify a certificate of public convenience and necessity. 220 ILCS 5/8-406(f). In light of the huge disparities in cost and rates, the Commission should conduct an *independent* audit, at the Company's expense, of IAWC's wastewater treatment operations to determine whether it is in the public interest to withdraw IAWC's certificate to provide wastewater treatment services. The Commission study should include an assessment of whether there are public or other wastewater treatment operators that can provide the service to IAWC water customers at a more reasonable and comparable cost. Waiting for rates to increase to $63.50 per month (excluding any other increases in cost) is not a viable option.

EXCEPTION XV: Proposed Language To Require An Independent Study Of Wastewater Treatment Service Options In The Areas Served By IAWC.

The language on page 189 of the Proposed Order should be changed as follows:

4. Commission Conclusion

It is the Commission's understanding that IAWC has proposed Chicago Metro sewer rates that are based upon its cost of service study. Importantly, IAWC has proposed to eliminate the declining block usage rate for residential customers and it appears no party objects to that proposal. In addition to <u>addressing</u> ~~complaining about~~ the overall level of IAWC rates for the Chicago Metro sewer district, the AG recommends that wastewater treatment rates increase by no more than 50%. Staff, for the most part, agrees with IAWC's proposed rate design. In an effort to mitigate bill impacts, promote gradualism and reduce rate shock, Staff proposes shifting a portion of the revenues to the residential class single-block usage rates in an effort to alleviate significant rate increases to the commercial customer class without an adverse impact to other classes.

While the Commission understands the AG's concerns, it does not appear to actually take issue with IAWC's cost of service study for the Chicago Metro sewer district. Additionally, Mr. Rubin indicates he does not know why IAWC's costs are "so high" and does not know why the Company would have such a high capital-related cost. (AG Ex. 2.0 at 24-25) The AG has presented the wastewater treatment charges in several communities near or in IAWC's service territory, and IAWC's cost of wastewater treatment is quite high by comparison. ~~Finally, in the Commission's view,~~ Although the AG has not provided an ~~adequate~~ explanation of how its proposed 50% rate cap could be implemented or how it would work, the Commission notes that the Staff has recommended a rate design based on a lower revenue requirement, that does not increase residential wastewater treatment costs by more than 50%, thus addressing the AG's concern. ~~The Commission concludes that the rate design proposal of the AG for the Chicago Metro sewer district is not supported by the record and it is not approved.~~

Staff asserts that its proposed rate design for the Chicago Metro sewer district, when compared to IAWC's, would reduce bill impacts for residential, commercial and multi unit residential from 56.97%, 128.92%, and 56.26%, to 42.41%, 82.93%, and 42.26% respectively. Staff also says that its proposed rates produce average bill impacts for residential, commercial and multi unit residential customers translate into approximately $20.78, $632.95, and $18.57 average monthly increases, while the rates in IAWC's initial filing produce average monthly increases of approximately $27.46, $1,000.11, and $24.24. It appears that the comparisons are based upon different revenue requirements, but the Staff's proposal is very close to the revenue requirement approved in this Order. ~~which reduces their usefulness to some extent. The Commission nevertheless believes that the comparisons provide some context for the IAWC and Staff proposals.~~

Having reviewed the positions of the parties, the Commission finds that Staff's proposal is more reasonable than IAWC's and should, therefore, be adopted. While the Commission generally favors cost-based rates, the Staff proposal in this instance represents a reasonable deviation from cost, in that it mitigates the potentially large impact on commercial customers without having an unreasonably large impact on other rate classes. To the extent the approved revenue requirement deviates from that proposed by Staff, any change should to rates should be implemented in the same manner as for water rates, via an across the board modification to Staff-proposed usage rates.

As indicated above, the AG witness recommended that IAWC be ordered to conduct an independent study, at IAWC's expense, of its wastewater treatment operations to assess, among other things, whether there are public or other wastewater treatment operators that can provide the service to IAWC water customers at a more reasonable and comparable cost. Municipalities Homer Glen et al. concur in that recommendation. IAWC opposes it.

On this issue, the Commission ~~does not~~ believes there is sufficient information in the record to support a finding requiring an independent audit. However, the cost and specific scope of ~~which~~ such an audit are unknown. Nevertheless, given the unreasonably and unusually large increase in wastewater treatment rates IAWC's cost of service implies, we need to assess whether IAWC's certificate of public convenience and necessity to provide wastewater treatment service should be altered. We will determine the scope and nature of the study and solicit bids from independent experts in the provision and cost of wastewater treatment service. ~~It is not clear that any such study or audit would produce a meaningful cost-effective result, or whether the Commission has the authority to implement the results of any such study or audit. The Commission declines to adopt the AG's recommendation at this time.~~

CONCLUSION

WHEREFORE, for the reasons stated above and in the Initial Brief and Reply Brief of the People of the State of Illinois, the People of the State of Illinois request that the Commission amend the Proposed Order and the schedules to the Proposed Order to reflect the changes recommended herein.

Respectfully Submitted,

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